BESSEMER TRUST

LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics

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Introduction

This LOOKING AHEAD summary addresses planning trends and important estate planning issues for 2025, including various current developments in 2024 and 2025. It includes some observations from the 59th Annual Heckerling Institute on Estate Planning™ that was held January 13-17, 2025, in Orlando, Florida. In particular, legislative developments involving the enactment of the "One Big Beautiful Bill Act" (OBBBA), including selected provisions, background issues, and planning considerations are highlighted in Items 3-10 below.

1. Trending in 2025

a. **Estate Planning 101 and 201.** Basic estate planning, including preparation of wills or revocable trusts (which will likely include appropriate trust planning for management and creditor protection), powers of attorney, health care documents, and coordination of life insurance, retirement benefits and other non-probate assets will always be of primary importance for the bulk of the population. Planning to minimize federal estate tax will also be important for clients with estates larger than about $15 million. For couples, this will include bypass trust planning, or portability planning (or a combination of the two).

b. **Shift Away From Federal Transfer Tax Planning as a Primary Concern.** For the 99.5% of the U.S. population with assets under $15 million, federal transfer taxes are of diminishing concern following the permanent increase of the gift. estate, and GST "exemptions" to $15 million in 2026 (indexed for inflation thereafter) in the "One Big Beautiful Bill Act" (OBBBA) (the Act). The exemption amount could be decreased by future legislation (though that would likely take a Democratic sweep of the Presidency, Senate, and House with voting power considerably larger than a mere majority) or the client's assets might appreciate higher than the inflation rate increases the federal exemption amount, but federal transfer taxes may be low on the list of priorities. Some states have significant state estate taxes for which state estate tax planning may be important. But for many clients, income tax planning may become more important on the tax front (basis planning and planning to take advantage of some of the changes made by OBBBA). That planning may include greater consideration of using non-grantor trusts.

c. **Review of Wills and Revocable Trusts With Formula Clauses; Addressing "Unneeded" Trusts.** In view of the "permanence" of the $15 million indexed estate tax exemption, planners may review wills and revocable trusts with formula transfers to credit shelter trusts or GST trusts. The permanence of the large exemption amount may also mean that many existing credit shelter trusts or GST trusts will not yield any transfer tax advantages and, indeed, may be disadvantageous.

d. **Traditional Transfer Planning Issues.** Traditional transfer planning considerations include:

- Retaining an appropriate cushion for lifestyle needs;
- Grantor trust planning, including flexibility if the grantor wants to stop having to pay income tax on trust income;
- Spousal lifetime access trusts (SLATs) created with one spouse's property that includes the other spouse as a discretionary potential beneficiary;
- Transfers other than SLATs with continued possible indirect access;
- Non-reciprocal trusts;
- Sales to grantor trusts;
- Making ownership transfers between spouses to facilitate later gifts;
- GST planning;
- Topping off gifts:
- Defined value clauses; and
- Adequate disclosure reporting

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

e. **Planning with QTIP Trusts.** Two very important cases in 2024 regarding the application of §2519 to modifications of QTIP trusts have focused attention on the difficulties of planning to minimize the eventual estate tax on assets in QTIP trusts. See Items 20 and 21 below.

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

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

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

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

2. Legislative Developments (Other Than OBBBA)

a. **FY 2025, FY 2024, and FY 2023 Greenbooks; IRS Funding.** Tax legislative proposals from the Biden Administration in the FY 2025, 2024, and 2023 Greenbooks included detailed extensive legislative tax proposals (with broad sweeping changes for transfer taxes and grantor trusts), as summarized in Item 3.a. of LOOKING AHEAD-Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** The Trump administration budget proposals during President Trump's first term and during his second term have not included detailed legislative tax proposals.

b. **IRS Funding.**

(1) **Clawback of Funding from Inflation Reduction Act**. The Inflation Reduction Act of 2022 included $79.6 billion of additional long-term IRS funding available until September 30, 2031. However, about $41.8 billion of the $45.6 billion in IRS enforcement funds under the Inflation Reduction Act have been clawed back (in various stages). *See* Cady Stanton, *Senate Passes Stopgap Stripping $20B From IRS, Avoiding Shutdown*, TAX NOTES TODAY FEDERAL (Mar. 17, 2025).

A report from the IRS dated Nov. 1, 2025, states that by the end of FY2025 (i.e., Sept. 30, 2025), the IRS had spent nearly $16 billion of the funds appropriated to it under the Inflation Reduction Act (and that had not been rescinded in subsequent legislation) and had about $21.7 billion of those funds remaining. After three different rescissions of enforcement funds authorized in the Inflation Reduction Act, the IRS was allocated $3.85 billion for enforcement, and $3.71 billion of that had been spent, leaving only about $136 million by the end of FY2025. *See IRS has $22 Billion in IRA Funds Remaining*, TAX NOTES TODAY FEDERAL (Nov. 1, 2025).

Funding bills for the IRS for FY2026 are pending; the Senate would include $11.8 billion for the IRS (a 4 percent cut from FY2025 funding level) and the House would include $9.5 billion for the IRS (a 23 percent overall cut in the IRS's budget). The biggest difference is in the funding levels for enforcement; the Senate would keep the enforcement level flat while the House would reduce enforcement funding by 45 percent, down to $3 billion. *See* Cady Stanton, *Congress Has Differences to Square on IRS Funding in 2026*, TAX NOTES TODAY FEDERAL (Jan. 2, 2026).

Unspent funds for the IRS under the Inflation Reduction Act for upgrading technology and rebuilding the workforce have largely been used to keep IRS operations open during the first week of the government shutdown. The IRS halted most of its operations after one week of the shutdown except for essential employees.

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

(2) **Further Proposed Funding Reductions.** The Trump administration's budget proposal is to cut discretionary funding to the IRS by $2.5 billion, from $12.3 billion in each of the last three fiscal years, 2023-2025, to $9.8 billion in fiscal year 2026 (beginning Oct. 1, 2025). The last time the IRS's annual budget was lower than that was in 2002, when it was $9.5 billion. A Technical Supplement Appendix to the 2026 Budget, released May 30, 2025, cuts the IRS funding to $9.8 billion, The detailed budget would allocate $3.6 billion for enforcement, down 33 percent from $5.4 billion for fiscal 2024 and 2025. The administration says the IRS enforcement reduction "ends the Biden Administration's weaponization of IRS enforcement." *See* Cady Stanton & Benjamin Valdez, *Detailed Trump Budget Request Would Slash IRS Enforcement Funds,* TAX NOTES TODAY (June 2, 2025).

A bill advanced by the House Financial Services and General Government subcommittees on July 21, 2025, would cut the IRS funding in fiscal year 2026 to $9.5 billion, compared to the current funding of $12.3 billion. The largest cut would be made to IRS enforcement, getting $3 billion, down from $4.4 billion in fiscal year 2025. *See* Chris Cioffi, *GOP Bill to Slash IRS Funding Approved by House Pane*l, BLOOMBERG DAILY TAX REPORT (June 21, 2025).

(3) **Impact of IRS Funding Cuts on Revenue Collections.** The anticipated revenue increases from the additional $45.6 billion of enforcement funds in the Inflation Reduction Act had been estimated anywhere from 2.5-to-1 to as much as 12-to-1 (the higher figure applies to audits of high-income taxpayers). The Congressional Budget Office Economic Outlook Report in January 2025 estimated that the $20 billion of rescinded funds (at that point) for enforcement "would reduce individual and corporate income tax receipts over the 2025-2034 period by $66 billion—resulting in a net increase in the projected cumulative deficit of $46 billion." Congressional Budget Office, THE BUDGET AND ECONOMIC OUTLOOK: 2025 TO 2035, at 14 (January 2025).

The funding cuts have resulted in cuts of IRS employees. Former Treasury Secretary Lawrence Summers estimates that the IRS staff reductions may eventually result in up to $1 trillion of lost revenue over the next decade. *See* Christopher Anstey, *Summers Says 'Attack' on IRS May Risk a $1 Trillion Revenue Hit*, BLOOMBERG DAILY TAX REPORT (April 22, 2025). The Budget Lab at Yale forecasts that terminating 18,000 IRS employees would result in a net revenue loss of about $159 billion over ten years, which could rise to as much as $1.6 trillion if non-compliance were high. *See id*. Chye-Ching Huang, executive director of the Tax Law Center at New York University School of Law said on April 15, 2015, that the loss of 20,000 employees [who had just announced they would accept the deferred resignation program) "will cost the federal government hundreds of billions of dollars in revenue while putting taxpayer services and privacy at risk as critical employees are either laid off or see no alternative but to resign their posts." Benjamin Valdez, *Nearly 20 Percent of IRS Staff Accept Second Resignation Offer*, TAX NOTES TODAY FEDERAL (April 16, 2025).

The combination of the plan to eliminate the Tax Division in the Department of Justice (placing tax litigators in the Civil and Criminal Divisions), cuts to IRS funding, and allowing a government agency (ICE) to access taxpayer information, suggest an increased possibility of inconsistent tax enforcement matters for taxpayers and politicization of the tax system. *See* Karen Kelly, *Inconsistent Tax Enforcement is a Threat to All*, 189 TAX NOTES FEDERAL 623 (Oct. 27, 2025) ("Without the Tax Division to stand vigilant and ensure the uniform and fair enforcement of the tax laws against citizens, and in the absence of experienced and empowered civil servants at the IRS, the risk of tax laws being weaponized is real … A politicized IRS would be viewed as untrustworthy by taxpayers and would inevitably damage the voluntary compliance system that is the foundation of our tax system.")

(4) **Reduction of IRS Employee Workforce.** The IRS has taken steps to utilize the additional funding for enforcement that it has been able to access and has added to its headcount for enforcement (including adding estate and gift tax examining officers), but the Trump administration is cutting IRS staffing. There are some reports that the Trump administration at one point was aiming to cut up to **half** of the IRS's roughly 100,000 workforce. *See* Erin Stowey, *Trump Aims to Cut IRS Workforce in Half by End of Year*, BLOOMBERG DAILY TAX REPORT (Mar. 4, 2025).

A June 2025 report from the National Taxpayer Advocate summarizes that the IRS workforce has fallen from 102,113 as of January 25, 2025, to 75,702 as of June 4, 2025, a drop of almost 26%. *National Tax Advocate Objectives Report to Congress Fiscal Year 2026* (June 25, 2025). The report observes that further cuts will be made because of the Administrations proposed 20% reduction in appropriated IRS funding next year.

A Report of the Treasury Inspector General for Tax Administration summarizes IRS workforce reductions as of May 2025. It says that 25,386 IRS employees have separated from the agency, took a deferred resignation program offer, or used another incentive to leave as of May 2025. The workforce has reduced by 25,386 employees, from about 103,000 employees in February 2025 to 77,428 employees in May 2025. Treasury Inspector General for Tax Administration, SNAPSHOT REPORT: IRS WORKFORCE REDUCTIONS AS OF MAY 2025 (July 18, 2025). For further detail about IRS workforce cuts in 2025, see Item 2.a of LOOKING AHEAD – Estate Planning in 2025 & Current Developments (Including Observations from Heckerling 2025 (June 30, 2025).

(5) **Tax Division of Justice Department Dissolved.** The almost century-old tax division of the Justice Department has been dissolved in a reorganization finalized Nov. 30, 2025. Tax enforcement functions are now split between the new tax litigation branch in the civil division and the tax section in the criminal division. The tax division had lost more than a third of its career managers, and about 40% of the Department's tax appellate attorneys have quit or been reassigned. As a result of the restructuring, any petition will likely go through additional layers of reviews by Department attorneys. *See* Erin Schilling, *What's Next After Justice Department Dissolved Its Tax Division*, BLOOMBERG DAILY TAX REPORT (Dec. 1, 2025).

c. **Second Reconciliation Act?** Only one reconciliation bill is allowed for each fiscal year, but the Sente parliamentarian has agreed that more than one reconciliation package can be worked on at the same time and that multiple reconciliation bills could be passed in a single fiscal year. See Cady Stanton & Doug Sword, *Doubt Growing on Chances for Second Reconciliation Bill This Year*, 188 TAX NOTES FEDERAL 468 (July 21, 2025). In the summer, House Speaker Mike Johnson (R-LA) expressed his goal to enact a second reconciliation act "in the late fall" of 2025. It would have included some priorities that did not make it into the first reconciliation act and some things that did not survive the Byrd test (he gave as one example, the provision that would have barred states from using their own funds to provide Medicaid to undocumented immigrants). Four or five committees would have been involved in writing the second bill, compared to eleven committees that were involved in crafting the first reconciliation act. It might also have addressed some technical corrections from the first act, which was enacted at great speed (without a Senate Finance Committee markup and without a Joint Committee on Taxation explanation of the final bill provisions.) See Jack Fitzpatrick, *Johnson Kicks Off Next Tax Bill Work, Seeking Fall Passage*, BLOOMBERG DAILY TAX REPORT (July 23, 2025).

A second reconciliation bill was not pursued in 2025. If Republicans think a second reconciliation bill could benefit them in the 2026 mid-term elections, a legislative vehicle could emerge in early 2026 before the election season begins in earnest. *See* Doug Sword, *Tax Redux: Could GOP Get Behind a Second Reconciliation Bill?*, TAX NOTES TODAY FEDERAL (Jan. 2, 2026); Cady Stanton, *Lawmakers Mixed on Trump Dismissal of Second Reconciliation Bill*, 189 TAX NOTES FEDERAL 1893 (Dec. 15, 2025). If Democrats win control of the House or Senate in the 2026 mid-terms, a lame duck reconciliation bill might be rushed through in late 2026 before surrendering to a divided government for the last two years of President Trump's term. *See Windows of Opportunity for Another Tax Bill*, MILLER & CHEVALIER TAX TAKE (Sept. 22, 2025).

House Budget Chair Jodey Arrington (R-TX) has said Republicans will seek deeper cuts to Medicaid and new spending reductions in Medicare. *See* Erik Wasson & David Gura, *Next Trump Budget Bill Begins Taking Shape in US House*, BLOOMBERG DAILY TAX REPORT (July 14, 2025). Sen. Ron Johnson (R-WI) voted for the first reconciliation act after threatening not to, has said that budget hawks were wooed by Republican leadership's promise of a second reconciliation bill that would include deeper spending cuts to offset the first bill's multitrillion-dollar hit to revenue. He said "I think I pretty well have a commitment they're going to do that." Chris Cioffi, *Crypto on Tap After Tax Megabill, but Goodwill in Short Supply*, BLOOMBERG DAILY TAX REPORT (July 16, 2025).

Tax changes could be addressed in 2026 in a second reconciliation act, in bipartisan legislation (some of the changes would have bipartisan support), or in an extenders package. See Katie Lobosco & Cady Stanton, *These Expiring Tax Provisions Could Get Renewed in 2026*, 190 TAX NOTES FEDERAL 136 (Jan. 5, 2026) (possible extenders include the work opportunity tax credit, reversing OBBBA's imposition of a 90 percent cap on gambling losses, adjust payments upward under the Medicare fee schedule and possible reconciliation act topics could include the Affordable Care Act enhanced credits and the proposed §899 retaliatory tax should OECD pillar 2 talks fail), The Congressional Budget Office estimates that the expiration of the Affordable Care Act premium tax credit will increase the number of uninsured people by 3.8 million in each year over the 2026-2034 period. *See* Katie Lobosco, *Bipartisan House Bill Would Extend ACA Tax Credit for One Year*, 188 TAX NOTES FEDERAL 1667 (Sept. 8, 2025).) Possible future tax proposals (now for 2026) include removing the gambling tax deduction cap, expat tax changes to avoid double taxation of U.S. citizens living abroad, retirement plan tax incentives (that have bipartisan support), IVF tax credit (for example, a $5,000 credit for taxpayers undergoing qualified fertility treatment), capital gains taxes on home sales (for example doubling the exclusion amount or eliminating capital gains taxes on home sales), and taxation of digital assets. *See* Katie Lobosco, *Six Tax Changes Congress Could Tackle This Fall*, 188 TAX NOTES FEDERAL 1678 (Sept. 8, 2025).

d. **Technical Corrections for OBBBA.** At some point, technical corrections will be needed for what is known as the One Big Beautiful Bill Act (OBBBA). Whether that will proceed on a bipartisan basis to correct noncontroversial measures is uncertain. Bipartisan technical corrections traditionally were the norm, even for corrections to partisan bills, but that changed after 2010 when Republicans refused to do anything to assist in furtherance of the Affordable Care Act. Since that time, both parties have been reluctant to assist with technical corrections to the other party's partisan legislation. *See* Doug Sword, *Get Ready for a Parade of Technical Corrections on Tax Bill*, TAX NOTES TODAY FEDERAL (Aug. 6, 2027).

e. **Hawley Medicaid Bill.** Sen Hawley voted for the 2025 Reconciliation Act, even though he had been extremely critical of Medicaid cuts in the Act. He subsequently filed the "Protect Medicaid and Rural Hospitals Act" proposed legislation that would reverse two major Medicaid cuts in OBBBA (limitations on the use of provider taxes and limitations related to state directed payments) and would double the fund to provide support for rural health facilities from $50 billion to $100 billion.)

f. **Ending Capital Gains on Primary Home Sales.** The No Tax on Home Sales Act (H.R. 4327) , introduced by Rep. Marjorie Taylor Greene (R-GA) would eliminate the capital gains tax on the sale of primary residences. The law currently provides an exclusion of just $250,000 ($500,000 for joint returns). President Trump has indicated he would be open to that relief in an effort to boost the housing market if the Federal Reserve does not reduce the interest rate, which have been blamed for

a slump in home sales and construction. The measure has been criticized has primarily benefiting higher income taxpayers. For example, a couple with a $250,000 home would not experience any benefit from the unlimited exclusion until the value of their home had more than tripled in value (resulting in a gain of more than $500,000) whereas a couple with a $5 million home would benefit if the home appreciates by more than just ten percent. *See* Alexander Rifaat, *Trump Dangles Elimination of Capital Gains Tax on Home Sales*, 188 TAX NOTES FEDERAL 634 (July 28, 2025). President Trump has indicated he would be open to that relief in an effort to boost the housing market if the Federal Reserve does not reduce the interest rate.

The More Homes on the Market Act (H.R. 1340), reintroduced in February by House Ways and Means Committee member Jimmy Panetta (D-CA), would raise the exclusion to $500,000 ($1,000,000 for joint returns) in index the cap for inflation. The law currently provides an exclusion of just $250,000 ($500,000 for joint returns), which was set in 1997.

Items 3-11 summarize provisions in, the background behind, and planning considerations under the "One Big Beautiful Bill Act" (OBBBA) (sometimes referred to as the Act).

3. Overview of "One Big Beautiful Bill Act" (OBBBA) (the Act)

a. **Introduction to the Act**. The primary legislative focus of Congress in 2025 has been the massive reconciliation package that includes pretty much all of the Trump administration's domestic legislative priorities. It is known as "One Big Beautiful Bill Act" (OBBBA), though that is not its official title. (The OBBBA is sometimes referred to in this summary as "the Act.") It was enacted under a special "reconciliation" legislative process that allowed it to pass by only a majority vote in the Senate (rather than the traditional 60-vote requirement for ending debate and bringing a bill to a vote).

The Act extends the 2017 Tax Cuts and Jobs Act (TCJA), adds other tax cuts that have been administration priorities, adds substantial additional appropriations for defense, border security, and immigration enforcement, makes a large number (and dollar amount) of spending cuts (including for Medicaid, the Affordable Care Act, and nutrition programs), increases the debt ceiling by $5 trillion, and includes numerous other miscellaneous measures. (In addition, some premium credits under the Affordable Care Act were not extended.) The Act cuts taxes by $4.5 trillion over the next ten years, cuts spending by $1.7 trillion, and adds $450 billion of increased spending (largely for defense, border security and immigration enforcement). The nonpartisan Congressional Budget Office and Joint Committee on Taxation estimate that the Act will add $4.1 trillion to the federal debt over ten years (including interest that will be paid on the additional debt). See Item 5.d below.

Of interest to many clients has been whether the federal estate and gift exclusion amount (currently about $14 million) would be extended or whether it would revert to about $7 million in 2026. The Act even further increased the exclusion, increasing it to $15 million in 2026 (to be inflation adjusted in the future). Like the rest of the extension of the TCJA matters, this provision is extended indefinitely (and does not "sunset" after a period of time, as typically happens with reconciliation legislation). The Act includes a number of individual as well as some business income tax provisions.

The indefinite extension of most (but not all) of the tax provisions in the Act was accomplished with a technique that has never been used before in any reconciliation legislation. The Senate determined by majority vote that the chair of the Senate Budget Committee could decide to use a "current policy" (rather than "current law") baseline for measuring the fiscal impact of the Act, and that permitted the indefinite extension of the Act's tax provisions.

Central to the Congressional negotiations was the cost of the Act. It comes with a big price tag—it is estimated to add about $4.1 trillion to the national debt by 2034 (and that is on top of the expected $20 trillion of deficits expected over the next ten years before enactment of the Act).

Selected provisions of the Act are briefly highlighted and background issues behind the negotiations that led to the ultimate assembly of the Act are summarized.

b. **Brief Overview of Major Provisions of the Act.** The mammoth 878-page Act contains sprawling provisions affecting many disparate areas of domestic policy. As a broad overview, the Act includes measures for the following broad areas (among many other miscellaneous provisions).

(1) **Tax Cuts.** The Act extends the 2017 Tax Cuts and Jobs Act (TCJA) and extends various business provisions that were in the TCJA but had already expired. The Act also adds various other tax cuts that were priorities of the Trump administration (Cost for 2025-2034: $4.45 trillion, as estimated by the Joint Committee on Taxation).

(2) **Defense.** An additional $157 billion is allocated to defense.

(3) **Border Security and Immigration.** Over $170 billion is added for border security and immigration. ICE's current annual budget is around $10 billion. The agency will receive through 2029: $45 billion for detention facilities; $46 billion for border wall operations; and $14 billion for deportation operations. ICE currently has 6,000 deportation officers and will add an additional 10,000 agents by 2029. For some leaders, this was a key provision in the Act. When the Act was nearing final stages of negotiations in the Senate, Vice-President JD Vance emphasized the importance of the immigration enforcement provisions: "Everything else – the CBO score, the proper baseline, the minutiae of the Medicaid policy – is immaterial compared to the ICE money and immigration enforcement provisions." (Posting on X by JD Vance, June 30, 2025)

(4) **Spending Cuts—Medicaid and Affordable Care Act.** The Act reduces federal Medicaid and health care spending by about $1 trillion over 2025-2034. The Congressional Budget Office (CBO) estimated the Senate Budget Committee's version of the bill would increase the number of uninsured people by 11.8 million (subsequently reduced to 10 million) by 2034. Various members of Congress expressed concern that the cuts would especially impact rural health care, and the Act adds a $50 billion fund (funded with $10 billion over each of the next five years) that could be used to assist rural health care providers. The Act also codifies changes to the Affordable Care Act marketplaces (in addition to the expiration of enhanced premium tax credits that expire at the end of 2025); the CBO estimates that those changes will result in loss of coverage for more than 5 million people. Many of these changes and spending cuts will not take place until after 2026.

(5) **Spending Cuts—Nutrition Programs.** The Act cuts about $230 billion over ten years from the Supplemental Nutrition Assistance Program (SNAP), sometimes referred to generically as "food stamps."

(6) **Phase-Out or Elimination of Clean Energy Credits**. The phase-out or elimination of various clean energy credits from the Inflation Reduction Act are estimated to result in $543 billion of savings.

(7) **Debt Ceiling.** The debt ceiling is increased by $5 trillion. (The U.S. currently runs a deficit of close to $2 trillion per year; it was $1.7 trillion in FY2023, $1.8 trillion in FY2024, and is expected to be $1.8 trillion in FY 2025.)

(8) **Numerous Other Provisions.** The massive bill has numerous other miscellaneous provisions

4. Summaries of Selected Tax Cuts Under the Act

The Act indefinitely extends the TCJA (with some modifications), indefinitely extends business provisions in the TCJA that had already expired, and adds various other new tax cuts (some of which last only for five years). Unless indicated to the contrary, all of these tax cut provisions are extended permanently (until a future Congress changes them). The permanence feature is particularly important even though the provisions could be changed by a future Congress because it means that avoiding the sunset of tax cuts cannot be used as leverage to obtain other concessions. Also, supermajorities in the House and Senate (that is, much larger than 50% for the Senate or 50% plus one for the House) might be needed to reverse the tax cuts. The purpose of the Senate's use of the "current policy" baseline was to extend the tax cuts permanently, without having them expire beyond the ten-year "budget window" of the reconciliation package (as typically happens with tax cuts in reconciliation legislation).

Cost estimates for 2025-2034, as determined by the Joint Committee on Taxation, are included for some of the measures. Observe that these are nine-year rather than the traditional ten-year costs in reconciliation legislation because the budget window begins in 2025, and the tax cuts generally are in place for 2025 and are only extended beginning in 2026.

Unless stated otherwise, all the provisions in the Act described below are effective beginning in 2026. (One of the features about the Act, though, is its array of different effective dates and varying phase-out amounts and phase-out rates for some provisions that apply to taxpayers with incomes above or below specified amounts.)

a. **Estate Tax.** The federal estate and gift exclusion amount (currently about $14 million) not only does not revert to about $7 million in 2026, but the exclusion amount is further increased to $15 million in 2026 (to be inflation adjusted in the future). This $15 million amount for 2026 is about $720,000 more than the exclusion amount would have been if the current law was extended. (The Joint Committee on Taxation Report estimates that the exemption would be $14.28 million in 2026 if current law was extended.) The change of the estate tax basic exclusion amount in §2010(c)(3) also automatically adjusts the gift tax exemption amount (§2505(a)(1)) and the GST exemption amount (§2631(c)). Significantly, the Act does not change the estate and gift tax rates or make any other transfer tax changes. There was no serious consideration in the legislative negotiations to repeal the estate tax. ($211.7 billion cost)

b. **Income Tax Rates.** The rate brackets in the TCJA are extended (and an additional year of inflation adjustment is added for the 10%, 12%, and 22% brackets). ($2.19 trillion cost)

c. **Increased Standard Deduction; No Personal Exemption.** The personal exemption is terminated and the increased standard deduction is permanently extended and enhanced; it will be $16,000 (single taxpayer) and $32,000 (married filing jointly) in 2026, and inflation adjusted thereafter. ($1.42 trillion cost for the increased standard deduction)

   Despite the increase of the standard deduction, the number of itemizers is expected to increase by five million taxpayers (to 23 million itemizers) for 2025 primarily because of the increase of the SALT cap to $40,000 for 2025. *Impact of the 2025 Reconciliation Act on the Number of Itemizers, 2025-35 Calendar Years*, URBAN-BROOKINGS TAX POLICY CENTER (July 16, 2025).

d. **Alternative Minimum Tax.** The increased exemption amounts and phase-out thresholds for alternative minimum tax (AMT) are extended with modest changes. ($1.36 trillion cost)

e. **Child Tax Credit; Dependent Care FSA.** The child tax credit was an important issue in the Presidential campaign. Both parties pledged to retain (or even increase) it. The Act increases the nonrefundable child tax credit to from $2,000 to $2,200 per child beginning in 2025, and it will be inflation adjusted after 2025. Eligibility requirements are tightened (for example, the parent must have a valid Social Security number). The inflation adjusted refundable child tax credit ($1,700 in 2025) is retained. ($817 billion cost)

   The annual contribution cap for dependent care flexible spending accounts (FSAs) will increase from $5,000 to $7,500 for single individuals and married couples filing jointly beginning in 2026. (It is not indexed for inflation.)

f. **Qualified Business Income.** The §199A deduction for qualified business income (QBI) is extended, leaving it as a 20% deduction (it was otherwise set to expire in 2026). (The House proposal had increased it first to 22% and later to 23%, but the final Senate version reduced it back to 20%. This maintains a top effective tax rate of 29.6% on this flow-through income.)

   The deduction for specified trades or businesses (SSTBs) phases out for income above the "threshold amount" (in 2025, $197,300 for single filers and $394,600 for joint filers) over a range of $50,000 ($100,000 joint) under current law, increased to $75,000 ($150,000 joint) beginning in 2026. So, more taxpayers in specified trades or businesses may be entitled to a partial deduction under §199A.

The phase-out range is similarly increased for purposes of whether the W-2 wage limitation is applied in determining the amount of the §199A deduction.

Taxpayers with at least $1,000 of qualified business income from an active trade or business are eligible for a minimum deduction of $400, indexed for inflation. ($737 billion cost)

g. **State and Local Tax Deduction.** The $10,000 cap on the deduction for state and local income, sales, and property taxes (SALT) is increased to $40,000 ($20,000 for married filing separately) beginning in 2025. The increased deduction phases out for income (married filing jointly) between $500,000 to $600,000 in 2025 (at which time it is back to $10,000). The $40,000 cap and the phase-out thresholds increase by 1% per year. This increased cap is effective only for 2025-2029; thereafter the $10,000 cap applies.) ($325 billion cost for SALT deduction increased cap for five years and the AMT changes)

   Most states have enacted a pass-through entity tax (PTET) as a workaround to the SALT cap. The House version limited the available of the workaround for persons in specified trades or businesses (attorneys, accountants, and doctors, among others), but that provision was not included in the Act. (A PTET election should be considered for eligible taxpayers in high-tax states that have the workaround in place.)

   The significant increase in the SALT deduction cap increases the comparative advantage of using non-grantor trusts, which can now deduct up to $40,000 of state and local taxes and possibly avoid phaseout if income would otherwise have exceeded $500,000 (keeping in mind that the increased cap is only for five years unless it is further extended).

h. **Home Mortgage Interest.** Limitations on the deduction of mortgage interest and home equity interest are made permanent (§163(h)). The deduction of mortgage interest is limited to acquisition indebtedness of $750,000 for new mortgages, and no deduction is allowed for home equity loan interest. Parents loaning money to children to acquire a home should secure the loan with a mortgage on the residence and comply with the detailed requirements of §163(h). The Act restores the deduction of mortgage insurance premiums (deductible as mortgage interest under the same cap).

i. **Termination of Miscellaneous Itemized Deductions**. The suspension of miscellaneous itemized deductions under §67(g), now in §67(h) including investment management and tax preparation fees, is extended permanently. Itemized deductions listed in §67(b), which are excluded from the definition of miscellaneous itemized deductions, may still be deducted but will be subject to a new limitation for high-income taxpayers, described immediately below.

j. **Pease Limitation Replacement**.

   (1) **General Description.** The Act replaces the Pease provisions with a new limitation, limiting the benefit of itemized deductions to about 35% instead of the current 37% level for taxpayers in the 37% bracket. The new 2/37ths limitation on itemized deductions is a much better deal for taxpayers than the Pease limitation would have been. Itemized deductions must be reduced by 2/37 (about 5.4%) of the amount by which the taxpayer's income exceeds the amount at which the 37% bracket begins ($768,700 for joint returns in 2026). (The House version had added a limitation related to the SALT deduction, which would have partly eroded the enhanced SALT deduction cap, but that was eliminated in the Senate.)

   The actual calculation under §68 is a little more complicated. The amount of itemized deductions otherwise allowable for the year (without regard to this limitation) is reduced by 2/37 times the lesser of (1) the amount of such itemized deductions, or (2) so much of the taxable income for the year (determined without regard to this cutback but increased by the amount of "such itemized deductions" (i.e., without regard to any cutback) as exceeds the dollar amount at which the 37% rate bracket begins.

   (2) **Example.** Assume a married couple in 2026 has $1,000,000 of adjusted gross income and aggregate deductions of $235,000, consisting of: $40,000 state and local taxes (but the deduction is limited to $10,000 because of the $500,000 - $600,000 phase out of the increased SALT

deduction) and $195,000 charitable contributions (but the charitable deduction is limited to $190,000 [it is reduced by $5,000 because of the 0.5% floor, 1,000,000 x .005 + 5,000]. Therefore, the itemized deductions, before the 2/37ths reduction, are $10,000 + $190,000 = $200,000.

Calculation of the 2/37ths reduction: For calculation simplicity, assume the 37% bracket in 2026 would begin at $760,000. The reduction is 2/37 times the lesser of (1) total itemized deductions (determined without regard to the 2/37 reduction, or $200,000); or (2) the amount by which the taxable income (determined without regard to the 2/37 reduction, or $800,000) plus itemized deductions (determined without regard to the 2/37 cutback, or $200,000) exceeds $760,000 (the assumed beginning of the 37% bracket in 2026) – $1,000,000 - $760,000 = $240,000. The lesser of $200,000 and $240,000 is $200,000, so the 2/37 reduction is $200,000 x 2/37 = $10,811.

Therefore, the amount of the allowable itemized deductions is $200,000 - $10,811, = $189,189.

(3) **Application to Trusts and Estates.** For estates and trusts, this provision may apply to expenses unique to estates and trusts and distribution deductions (under §651 or §661). The result is uncertain.

(a) **Generally Applies to Estate and Trusts Even Though §68 Applies "In the Case of an Individual."** What about the fact that new §68(a) applies "[i]n the case of an individual"? Does that mean it does not apply to estates and trusts? The current §68 has the same "individual" language, but Congress felt the need for §68(e) to provide that it does not apply to estates and trusts. The Act deletes §68(e) (saying that §68 does not apply to estates and trusts) for years beginning after December 31, 2025. Furthermore, §641(b) says that "the taxable income for an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part." Also, §642(c) says "in lieu of the deduction under Section 170," and that would not be needed if the general rule of §642(b) did not apply. Finally, the Senate Finance Committee summary of the Act published on July 31, 2025, says the provision is "applicable to individuals, estates, and trusts." (Interestingly, the earlier explanations from the Senate Finance Committee did not include that statement.)

(b) **But Does §68 Apply to Expenses Unique to Trusts and Estates?** Under §641(b), the same income tax rules apply to trusts and estates and trusts as for individuals **"except as otherwise provided in this part."** Accordingly, does §68 apply only to estate and trust deductions that are "in the same manner as in the case of an individual" but not to special deductions under Subchapter J that apply to estates and trusts and not to individuals (for example, the distribution deduction and expenses unique to the administration of trusts and estates that are not commonly or customarily incurred by individuals)? Are deductions unique to trusts and estates incorporated in the "except as otherwise provided in this part" clause of §641(b) and therefore not within the scope of taxation "in the case of individuals," and therefore not subject to §68? Indeed, some of the trust and estate income tax provisions, such as §§651, 661, and 642(c), although called "deductions" are more in the nature of allocations of income to beneficial owners. This statutory ambiguity could have been avoided if §68 had specifically created an exception for expenses unique to estates and trusts like in §67(e).

(c) **If §68 Applies to Deductions Unique to Estates and Trusts, Statutory Analysis Suggests That Deductions for Unique Trust Expenses and Distributions Are "Itemized Deductions" Subject to §68.** The following analysis suggests that estate and trust unique expenses and distributions deductions are subject to the 2/37ths reduction. Section 67(e) says that trust expenses incurred solely because the expenses were incurred by a trust (such as the portion of trustee fees not attributable to investment management expenses) or distribution deductions under §651 or §661 are treated as allowable in arriving at adjusted gross income, but that applies only "[f]or purposes of this section" (i.e., disallowing deductions for miscellaneous itemized deductions under §67). Section 68 applies the 2/37ths reduction to "itemized deductions," and §63(d) says that for purposes of Subtitle A [i.e., income taxes], the term "itemized deductions" means all deductions allowable under

Chapter 1 other than the deductions allowable in arriving at adjusted gross income and deductions listed in §63(b). Deductions allowable in determining adjusted gross income are listed in §62. Neither §62 nor §63(b) list §651 or §661 distribution deductions. Accordingly, expenses unique to trusts and §651 and §661 distribution deductions are itemized deductions that are not disallowed under §67 as miscellaneous itemized deductions, but they are still "itemized deductions" and therefore are subject to the §68. Applying the 2/37ths reduction to distribution deductions means that some **double taxation** of trust income will result (because the amount of income taxed to the beneficiary under §652 or §662 is not reduced by the 2/37ths reduction).

(d) **But Regulations State Generally (Probably Incorrectly) That Deductions for Unique Trust Expenses and Distributions Are Allowed in Determining Adjusted Gross Income (and Therefore Are Not "Itemized Deductions").** Despite the statutory language of §67 and §63, Treasury Regulations state that unique trust administration expenses and distribution deductions under §651 and §661 "are not itemized deductions," and the regulation does not say that is effective only for purposes of §67. (If they are not "itemized deductions," they would not be subject to the 2/37ths cutback under §68.)

> (a) Deductions. –(1) Section 67(e) deductions. –(i) In general –An estate or trust … must compute its adjusted gross income in the same manner as an individual, except that the following deductions (section 67)e deductions) are allowed in arriving at *adjusted gross income*:
>
> > (A) Costs that are paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in such estate or trust; and
> >
> > (B) Deductions allowable under section 642(b) (relating to the personal exemption) and sections 651 and 661 (relating to distributions).
>
> (ii) Not disallowed under section 67(g). –Section 67(e) deductions *are not itemized deductions* under section 63(d) and are not miscellaneous itemized deductions under section 67(b). Therefore section 67(e) deductions are not disallowed under section 67(g).

Treas. Reg. §1.67-4 (emphasis added).

The IRS directs examiners that the IRS is bound by its regulations. Section 4.10.7.2.3.4 (01-01-2006) of the Internal Revenue Manual (available from the IRS website) provides: "(1) The IRS is bound by the regulations. The courts are not."

The contrary argument is that §67(e), by its terms, is limited to §67 and that any regulation promulgated under §67(e) must, therefore, be limited to §67. However, the IRS is very unlikely to take a position that would result in double taxation and therefore is likely to continue with the approach in Reg. §1.67-4(a)(1)(ii) that the deductions for unique trust administration expenses and the distribution deductions are not itemized deductions and therefore cannot subject to the 2/37ths cutback of itemized deductions under §68.

(e) **Section 642(c) Charitable Deduction.** The charitable deduction for trusts and estates under §642(c) is discussed in Item 4.m below.

(4) **Reduction Not Limited To Taxpayers With Income Subject to a 37% Tax Rate.** Another interesting aspect of §68 is that the 2/37ths reduction might apply to the extent that the trust's taxable income exceeds the amount at which the 37% rate bracket begins, even if all of the trust income is capital gain or qualified dividend income taxable at 20%. (That is likely inconsistent with the stated legislative intent.)

(5) **Other Deductions.** The 2/37ths cutback may have implications for other deductions as well. For example, the 2/37 cutback of the §691(c) deduction makes accelerating IRD on deathbed (before death) more attractive.

(6) **ACTEC Comments.** ACTEC on November 10, 2025, filed separate sets of comments with legislative staff and with the Treasury and IRS about these issues (as well as the application of §68 to the §642(c) deduction, Trump Accounts, and qualified small business stock provisions).

k. **Individual Charitable Deductions/Credits.**

(1) **60% Limitation for Cash Gifts.** The 60% adjusted gross income (AGI) limitation (more precisely, 60% of the "contribution base", which is AGI determined without regard to any net operating loss carryback to the taxable year) on cash-based charitable contributions to public charities is now permanent (otherwise, it would have reverted back to a 50% limitation in 2026).

(2) **0.5% Floor on Charitable Deductions.** A new floor will apply in determining total individual charitable deductions. Contributions will be deductible only to the extent they exceed 0.5% of the contribution base. For example, a taxpayer with income of $1 million could not deduct the first $5,000 of charitable contributions. Whether the portion that cannot be deducted can be carried over to future years is unclear. The carryover of the 0.5% haircut amount in a particular year may be allowed only if the taxpayer was otherwise entitled to a charitable deduction carryover for that year (*e.g.*, if the taxpayer had charitable contributions in excess of the 20%, 30%, 50%, or 60% limitations). §170(d)(1)(C).

The 0.5% haircut on charitable deductions applies in addition to the Pease limitation replacement on itemized deductions (which would apply to taxpayers with income in excess of the amount at which the 37% rate bracket begins), discussed in Item 4.j above.

To avoid the annual 0.5% haircuts, consider making a large contribution in one year to a donor advised fund that can fund desired annual charitable contributions for future years. The 0.5% floor and the Pease limitation replacement do not apply until 2026, so 2025 is a good year to bunch charitable contributions (perhaps with a large donation to a donor advised fund, which could be used to make charitable contributions in future years that the donor otherwise would have made in those years).

(3) **$1,000/$2,000 Above-the-Line Deduction.** Non-itemizing individuals are entitled to an above-the-line charitable deduction of up to $1,000 ($2,000 for joint filers) (not indexed for inflation). Contributions must be made directly to charity and not to a donor advised fund to qualify for this above-the-line deduction. This is an expansion of the $300/$600 above-the-line deduction allowed under the CARES Act. Over 41 million taxpayers took advantage of that deduction, resulting in over $2 billion of reduced tax payments.

(4) **$1,700 credit for Contributions to Scholarship Granting Organizations (Beginning in 2027).** A new $1,700 credit is available for cash contributions in 2027 and beyond to qualified Scholarship Granting Organizations (SGOs) that provide K-12 scholarships. (Contributions to donor advised funds or supporting organizations do not qualify.) This federal credit is only available for contributions to SGOs in states that choose to participate; states must proactively opt-in. Many states may be unlikely to participate in the program because their laws forbid it. *See* Tyrah Burris, *New Scholarship Tax Credit May Face Barriers From State Laws*, TAX NOTES (July 23, 2025). There are income limits on eligible scholarship recipients (students in households earning up to 300% of local median income). Contributions will typically be to provide scholarships for private schools. This has been referred to as a private school voucher tax credit, and the program could create an indirect way of funding private schools with taxpayer dollars. Revenue Procedure 2026-6, issued Dec. 12, 2025), allows states (and the District of Columbia) to make an Advance Election (using Form 15714) to participate in the new tax credit for calendar year 2027 before it provides the IRS with a list of the SGOs located in the state, allowing SGOs additional time to prepare for the commencement of the new credit in 2027, Notice 2025-70 provides additional guidance and a request for comments.

l. **Corporate Charitable Deductions.** Charitable deductions for corporations would be restricted. Corporations may deduct up to 10% of their taxable income. That ceiling on the deduction does not change, but a new 1% floor would be imposed. A corporation would have to make charitable contributions of at least 1% of its income to receive any charitable deduction. (The median corporate grant maker donates 0.92% of its pre-tax profit and thus would not be entitled to any charitable deduction.)

A possible way of avoiding these limits is to structure the charitable transfer in a way to generate a §162(a) business deduction. See Reg. §1.162-15(a), "Payments and transfers to entities described in

section 170(c)." Example 2 would allow a §162 business deduction for a partnership that operates a chain of supermarkets that has a promotional program to donate one percent of its sales each year to a community charity, reasonably believing that "will generate a significant degree of name recognition and goodwill in the communities where it operates and thereby increase its revenue."

m. **Trust and Estate Charitable Contributions; Impact of 2/37ths Reduction of Itemized Deductions.** The replacement under the Act for the Pease limitation (the old §68) will limit the benefit of itemized deductions to about 35% instead of the current 37% level for taxpayers in the 37% income tax bracket. That limitation also appears to apply to trusts and estates (because §68(e), which had exempted trusts and estates from the prior §68 Pease limitation, was not included in the new §68 under the Act). There are informal indications from the Joint Committee on Taxation that this omission was intentional. As discussed in 4.j(3)(a) above, even though §68(a) applies "[i]n the case of an individual," it generally applies to estates and trusts (but it may not apply to special deductions under Subchapter J that apply to estates and trusts and not to individuals, as discussed in Item 4.j(3)(b) above).

Section 642(c) says that a charitable deduction is allowed, "without limitation" to an estate or trust for gross income paid to charity (§642(c)(1)) and to an estate for gross income set aside to charity (§642)c(2)) if the requirements of §642(c) are satisfied. Does the "without limitation" clause mean that a §642(c) deduction is allowed without being limited by the 2/37ths reduction under §68(a)? Since its enactment in 1954, §642(c) has always said "without limitation." Section 642(c) was added to §67(b)(4) (as one of the itemized deductions that is not a "miscellaneous itemized deduction" subject to the restrictions of §67(a)) in TAMRA in 1988. Accordingly, the §67(b)(4) classification of §642(c) as an itemized deduction is a subsequent overlay on the "without limitation" language in §642(c). It is a different Code section (§68) that imposes the 2/37ths reduction as an "overall limitation on itemized deductions," and §68 does not specifically refer to §642(c). Still, the new §68(a) under the Act refers to "itemized deductions" under §67(b) (which specifically refers to §642(c)), and the Act eliminated §68(e), which said that limitations under §68 do not apply to trusts and estates. Accordingly, a literal reading of the statutes may suggest that the "without limitation" clause in §642(c) does not override the overall limitation on itemized deductions under §68.

An interesting article takes the contrary position. Daniel Gespass, *Pease Pease Me: The OBBBA's Revived Limitation on Itemized Deductions*, TAX NOTES TODAY FEDERAL (Aug. 26, 2025). Among other arguments, the article cites *United States v. Benedict*, 338 U.S. 692 (1950), in which the Supreme Court noted (in dicta) that statutory limitations applicable to the individual charitable deduction are inapplicable to the charitable deduction for trusts and estates because of the "without limitation" clause. The Court said the "without limitation" clause in the §642(c) predecessor did not override the requirement in that same section that the contribution be paid from gross income, but footnote 8 in *Benedict* says the effect of the "without limitation" clause "is only to make inapplicable the limitation of 15 percent, under section 23(o), and any other statutory limitation which otherwise might apply to charitable contributions made out of the gross income of an estate or trust." (Section 23(o) limited the individual charitable deduction to 15 percent of income.)

In *Benedict*, a testamentary trust said 45% of its income was to be distributed to charity. The Internal Revenue Code at that time (in §117(b)) included in gross income only 50% of capital gain from property held for more than two years. The issue was whether the trust charitable deduction (under §162(a), the predecessor of §642(c)) was 45% of all the capital gain, or just 45% of the 50% that was included in gross income (keeping in mind that under §162(a), as under the current §642(c)), the charitable deduction was allowed only for amounts distributed to charity from gross income).

> The Supreme Court held that only 45 percent of the unexcluded gain could be taken as a deduction because the gain excluded under section 117(b) is not included in gross income. The Court said that section 162(a) provided that the deduction could only be used for contributions that consist of gross income, and the amount of the gain excluded in section 117(b) was not included in gross income.
>
> Either responding to or anticipating an argument that "without limitation" somehow meant that even the requirement that the charitable contribution be included in gross income must be ignored, the Court said in footnote 8:

> When the words "without limitation," in section 162(a), are read in connection with section 23(o) . . . their effect is only to make inapplicable the limitation of 15 percent, under section 23(o), *and any other statutory limitation* which otherwise might apply to charitable contributions made out of the gross income of an estate or trust. [Emphasis added.]
>
> Section 23(o) of the 1939 code (the predecessor to section 170) limited the individual charitable deduction to 15 percent of income. In the footnote, the Court said that "without limitation" doesn't override the requirement in section 162(a) (now section 642(c)) that the contribution be paid from gross income. However, the Court also said that the "without limitation" language makes inapplicable both the 15 percent limitation under section 23(o) "and any other statutory limitation which might otherwise apply."

Daniel Gespass, *Pease Pease Me: The OBBBA's Revived Limitation on Itemized Deductions*, TAX NOTES TODAY FEDERAL (Aug. 26, 2025).

A subsequent article by Richard Fox (Gladwyne, Pennsylvania), thinks the better analysis is that *Benedict* is best analyzed to mean that "the phrase 'without limitation' in §642(c) was included specifically to make inapplicable the percentage limitations of IRS § 170, not to override other generally applicable statutory restrictions."

> As Justice Burton explained, the purpose of the fiduciary charitable deduction was to encourage giving out of gross income and 'to that end, it completely exempts such contributions from income tax, without the limitations imposed upon charitable contributions made by individuals or corporations.' He emphasized that, when read with IRC § 23(o), the predecessor to IRC § 170, the phrase "without limitation" served to make inapplicable the percentage ceilings imposed on individuals and corporations. At the same time, the Court confined the deduction to the portion of gain actually includable in taxable income under former IRC § 117(b), thereby making clear that "without limitation" did not displace other generally applicable provisions of the Code. The charity received the full $60,000, but the deduction was limited to the $30,000 portion of gain actually includable in taxable income under former IRC § 117(b).
>
> …
>
> While both positions have merit, the judicial track record — particularly *Benedict* and *Green* — suggests that courts are more likely to conclude that the phrase 'without limitation' was intended to remove only the percentage ceilings under IRC § 170's predecessor provision, not to shield fiduciary charitable deductions from generally applicable provisions such as the 2/37ths haircut under IRC § 68(a). That said, the broader interpretation remains colorable, may support a reporting position, and could ultimately be tested in litigation.

Richard Fox, *The 2/37ths Itemized Deduction Haircut and the IRS §642(c) Charitable Deduction: Does "Without Limitation" Really Mean Without Limitation?*, LEIMBERG INCOME TAX PLANNING NEWSLETTER #280 (Sept. 22, 2025).

The reference in §68 to "itemized deductions," and the specific reference to §642(c) as an itemized deduction in §67(b), together with the elimination of §68(e) saying that §68 does not apply to trusts and estates, leaves a possible statutory construction that the 2/37ths reduction as an overall limitation on itemized deductions applies to the charitable deduction for trusts and estates under §642(c).

The result is that trusts and estates with income in excess of the amount at which the 37% rate applies (which will be about $16,000 in 2026) may have a cut-back on the deductions under §642(c) for charitable distributions. *See* Bob Keebler & Jim Magner, *The 2/37ths Itemized Deduction Limitation Appears to Apply to Trusts and Estates*, LEIMBERG INCOME TAX PLANNING NEWSLETTER #272 (July 25, 2025). Edwin Morrow (Dayton, Ohio) provides this simple example. A non-grantor trust has $300,000 of gross taxable income going to charity, but the new §68 haircut says that we reduce the $300,000 deduction by 2/37 of the amount above where the 37% rate starts ($16,000 in 2026), or $284,000 times 2/37, or $15,351 taxable income on which the trust must pay income tax.

If an estate passes 100% to charity, for the estate set aside deduction under §642(c)(2) will this 2/37 reduction result in a circular formula computation? On the surface, it might seem that a circular computation would be required because the 2/37 reduction in turn reduces itemized deductions and increases taxable income, both of which are factors in the calculation. The provisions of §68 attempt to avoid the necessity of circular calculations, however, because the first paragraph of §68(a) refers to itemized deductions "determined without regard to this section," §68(a)(1) and (a)(2) refer to "*such* amount of itemized deductions," and §68(a)(2) refers to taxable income "determined without

regard to this section." However, applying the 2/37 reduction means the estate with 100% going to charity must pay income tax which would seem to reduce the estate's §642(c) deduction. Even though the 2/37 reduction under §68(a) may not be recalculated because of this reduction in the amount of the actual amount passing to charity, a circular calculation will still result if the charitable set-aside deduction under §642(c) is allowed only for the amount actually passing to charity (reduced by the income tax). The income tax payable by the estate reduces the charitable deduction, which further increases the tax, which further reduces the charitable deduction, etc.

If that circular calculation applies, significant income tax would result, but a substantial amount would still be left to pass to charity. For example, if an estate with $1.0 million of income passes entirely to charity, the §642(c) deduction would be reduced by 2/37 of $1.0 million - $16,000 [the 37% bracket starts at $16,000 in 2026], or $53,189. That would also reduce the charitable deduction, which produces more income tax, which further reduces the charitable deduction, which produces more income tax, which further reduces the charitable deduction, etc. After 12 iterations, the additional income tax would be less than $1, and the aggregate income tax would be $84,424, leaving $915,576 to pass to charity. The circular calculation is not a re-calculation of the 2/37ths reduction, but merely a circular calculation that results from some income tax being paid out of the charitable share of the estate, which reduces the charitable deduction, which further increases the income tax, etc.

A 1986 case suggests that perhaps the estate set-aside charitable deduction under §642(c)(2) will *not* be reduced by the income tax produced by reason of the 2/37 reduction of the charitable deduction. *Hartwick College v. U.S.*, 801 F.2d 608 (2d Cir. 1986) addressed this issue in the context of an estate that had $2.4 million of gross taxable income, and $1.0 million of administrative expenses that were deducted on the estate tax return and could not be deducted on the estate's income tax return. The resulting $1.4 million residuary estate passed to charity. If the full $1.4 million residuary estate amount could be deducted under §642(c) (even though the charity would not receive that full amount), the taxable income would be $1.0 million (i.e., the $1 million of administration expenses that were not deducted on the income tax return), and at a 70% rate, the tax would be $700,000. The government contended that the charitable deduction had to be reduced by the income tax (because the charity would not receive that amount). The result would have been that the charitable deduction would be reduced by $700,000, which would produce additional income tax of $700,000 x 70% = $490,000. That additional income tax would further reduce the charitable deduction, which would produce an additional $490,000 x 70% = $343,000 of income tax. The total income tax resulting from this calculation ($700,000 + $490,000 + $343,000 = $1,533,000), would have exceeded the $1.4 million of cash in the residuary estate. Thus, this circular calculation approach would have resulted in **no** amount passing to charity. The court refused to apply the government's circular calculation approach and allowed a charitable deduction for the full amount of the $1.4 million in the residuary estate, not reduced by income taxes. The court observed that the estate tax charitable deduction statute specifically requires that the deduction be reduced by the amount of estate tax payable out of the charitable bequest, but the income tax charitable deduction statute did not have that limitation. The court cited a Supreme Court case, *Edwards v. Slocum*, 264 U.S. 61 (1924), which had concluded that the estate tax charitable deduction would not be reduced by estate taxes payable from the charitable bequest (before the statute was changed to require that reduction), reasoning: "The Government offers an algebraic formula by which it would solve the problems raised by two mutually dependent indeterminates. It fairly might be answered … that 'algebraic formulae are not lightly to be imputed to legislators,' …"

Whether the *Hartwick College* result will apply in the context of the 2/37 reduction of the charitable deduction is not clear. A big distinction is that on the facts of *Hartwick College* (where $1.0 million of administrative expenses were not deducted for income tax purposes), if the income tax was subtracted from the charitable deduction, **no** amount would have passed to charity. However, if the circular calculation approach were used in the context of an estate passing entirely to charity with a 2/37 reduction of the §642(c)(2) estate set-aside charitable deduction, a significant additional income tax would result, but a substantial part of the estate would still pass to charity. The "all-or-nothing" result in *Hartwick College* would not apply, and a court might not be as persuaded to find a way to

avoid the circular computation analysis so that the charitable deduction would be allowed only for the amount actually passing to charity (after the estate pays its income tax).

Observe that the 2/37ths cutback on itemized deductions applies to individuals with income in excess of about $750,000 (the 37% bracket starts at $768,700 for joint returns in 2026), but the limitation applies to trusts and estates with income over only $16,000 (the 37% bracket starts at $16,000 in 2025). The cutback is far more significant for trusts and estates.

One possible approach of dealing with the cutback of the charitable deduction might be to structure the trust as a "BDOT" under §678, giving the charity the right to withdraw all income (including capital gain income). It is not clear, however, that would work, and planners may be reluctant to forego a charitable deduction under §642(c) entirely, in the hope of that having all income taxed to the charity (which would be an exempt entity and therefore pay no tax) under §678 would avoid this relatively very small cutback in the charitable deduction.

n. **No Increased Excise Tax On Private Foundations.** The House had increased the 1.39% excise tax on the net investment income of larger private foundations. The Act does not include that provision.

o. **Expansion of Qualified Small Business Stock Gain Exclusion.** Code Section 1202 currently provides for the exclusion of 100%, 75%, or 50% (depending on when the stock was acquired) of gain on the sale of C corporation qualified small business stock (QSBS) held more than five years. The exclusion is subject to a per-issuer cap—generally the greater of $10 million or 10 times the taxpayer's basis in the stock. Eligibility also depends on the corporation's aggregate gross assets not exceeding $50 million at the time of issuance.

The Act makes three significant changes, applicable for QSBS issued or acquired after July 3, 2025 (the date of enactment). (1) Tiered gain exclusion – the tiered gain exclusion is changed so it will be based on how long the stock has been held rather than when it was acquired. The gain exclusion is 50% for stock held at least three years, 75% for stock held at least four years, and 100% for stock held at least five years. (2) Per-issuer exclusion cap – the per-issuer dollar cap is increased from $10 million to $15 million (indexed for inflation). (3) Gross asset threshold – the corporate-level aggregate-asset ceiling is increased from $50 million to $75 million, indexed for inflation beginning in 2027. These changes are effective for taxable years beginning after the date of enactment. ($17 billion cost)

These three changes are very significant for small business owners. C corporations may become more favored, especially if sales of stock are anticipated in the near future (but after the stock has been held at least three years).

Having multiple non-grantor trusts own QSBS stock becomes more important for "stacking" of QSBS shares with the increased $15 million dollar cap. A planning alternative to minimize gift exclusion amount required to cover transfers of QSBS stock into separate non-grantor trusts is to use GRATS, with remainders to separate trusts that would become non-grantor trusts after the termination of the GRATs.

For planning considerations with QSBS stock under the Act (other than planning with trusts), see Aime Salazar, *Structuring for Expanded Benefits of Qualified Small Business Stock Under the OBBBA*, 188 TAX NOTES FEDERAL 1629 (Sept. 8, 2025). For a concise history of the QSBS provisions and criticism of the QSBS gain exclusion from a tax policy point of view, see David Mitchell & Kyle Pomerleau, *Congress Should Have Eliminated, Not Expanded, the QSBS Exclusion*, 189 TAX NOTES FEDERAL 15 (Oct. 13, 2025) (the QSBS exclusion is too complex, inefficient, and inequitable; for returns filed between 2012 and 2022, 74.4% of the QSBS gain exclusion was for the "$1M Plus" income group).

p. **Gambling Losses.** Gamblers are dealt a bad hand—the deduction for "losses from wagering transactions" is limited to 90% of the losses (only to the extent of the gains from such transactions).

q. **Educator Expenses.** The current $300 above-the-line deduction for educator expenses is continued. A new expanded itemized deduction (no dollar limit) is allowed after 2025 for unreimbursed employee expenses for K-12 teachers, instructors, counselors, interscholastic sports administrators

and coaches, principals, and aides in a school for at least 900 hours during a school year. The deduction is available for expenses such as books, supplies, computer equipment, and supplementary materials used in instructional activities. The expanded eligible expenses include sports related equipment used for instructional purposes.

r. **Selected Business Provisions (Generally Effective in 2025)**. Several business provisions in the TCJA that have already expired are extended indefinitely (generally effective beginning in 2025):

- Immediate expensing (100% bonus depreciation) under §168(k) of certain business property acquired and placed in service after Jan. 19, 2025; Assets placed in service on January 19 or earlier are subject to current rules with the phase down (40% for 2025, 60% for 2024); if property was "acquired" on or before January 19, 2025 but not placed in service until after 2026, the bonus depreciation is 0%) ($363 billion cost)
- Full expensing is permitted for domestic research and experimental expenditures paid or incurred in taxable years beginning after 2024 that are attributable to research in the United States (expenses for research outside the U.S. can only be deducted over 15 years); in addition, accelerated expensing is allowed (over a one- or two-year period) for expenditures after 2021 and before 2025; small businesses (gross receipts less than $31 million) can retroactively deduct research and development expenses back to December 31, 2021 ($141 billion cost)
- A relaxation of the limitation on deductions of business interest expense for taxable years beginning after 2024 ($61 billion cost)
- Special 100% depreciation allowance (new §168(n)) for the cost of "qualified production property," which includes new factories and improvements used in connection with manufacturing, agriculture, chemical production, or refining ($141 billion cost)

s. **Clean Energy Credits.** The Act repeals or phases out many of the key tax credits enacted in the 2022 Inflation Reduction Act. One example is that clean electricity credits are not allowed for wind and solar projects placed in service starting after 2027 if construction has not begun on the project within 12 months of the date of enactment. A notable change made by the Senate was to remove a new excise tax on new wind and solar facilities that could not meet aggressive material sourcing limits. The residential clean energy credit will be disallowed for any expenditure made after 2025 (moved up from Dec. 31, 2024) and the clean vehicle credit will be disallowed by any vehicle acquired after Sept. 20, 2025 (moved back from Dec. 31, 2032). The "placed in service" timeline is significant; banks may be reluctant to finance projects assuming they would be placed in service by that date because of uncertainties that could lead to construction delays (natural disasters, supply chain issues, etc.).

t. **Qualified Opportunity Zones (Changes Effective Beginning 2027).** The qualified opportunity zone investment regime was enacted as part of the 2017 TCJA. Three distinct tax advantages exist for investments in a qualified opportunity fund (QOF) under the first program.

(1) Deferral of existing gain. An investor who has sold property and realized gains may defer until December 31, 2026 (or when the QOF investment is sold) capital gains that are invested in a QOF within 180 days of when the gain was realized. The deferral of existing gain is accelerated upon the occurrence of an "inclusion event," which includes sales or gifts (other than gifts to grantor trusts) of the QOF investment.

(2) Exclusion of a portion of existing gain. Ten percent of the deferred gain can be excluded if the QOF is held at least 5 years, and 15% can be excluded if it is held at least 7 years by 2026; exclusion of 10% or 15% of the gain is accomplished by increasing the basis by that much.

(3) Possible nonrecognition of gains in QOF investment. If the QOF is held for at least 10 years, all the gain that is accrued after the investment in the QOF is excluded. (Observe, the QOF investment

could be retained for decades, allowing decades of gains to be excluded. But, as described below, for investments beginning in 2027, only 30 years of gains could be excluded.)

The Act permanently extends the benefits of investments in QOFs **beginning in 2027**, but the Act makes various changes for investments beginning in 2027.

(1) Deferral of existing gain. The set deferral date (December 31, 2026 under the first program) is replaced with a rolling 5-year schedule; gains can be deferred until 5 years after the investment is made (unless it is sold or exchanged prior to that time).

(2) Exclusion of a portion of existing gain. Ten percent of the deferred gain can be excluded if the QOF is held at least five years; the additional 5% step-up after 7 years is eliminated.

(3) Possible nonrecognition of gains in QOF investment. The nonrecognition provision is retained (if the investment is held at least 10 years), but if the investment is held over 30 years, the basis will be the fair market value on the date 30 years after the date of the investment; gain accumulated after the 30-year mark will be recognized when the investment is sold.

(4) Ten-year designations. Rolling qualified opportunity zone (QOZ) designations will be effective for 10-year periods. Beginning July 1, 2026, state governors will propose QOZ designations. After being certified by the Treasury Secretary, they will be effective for 10 years. The initial designations will be effective January 1, 2027 through December 31, 2036.

(5) More restrictive QOZ requirements. The Act restricts the definition of a "low-income community" (which is one of the categories of permissible qualified opportunity zone investments). In particular, the Act removes tracts that are not low-income but are contiguous to a low-income community from being designated as a QOZ. Also, a special rule for Puerto Rico was removed.

(6) Qualified Rural Opportunity Zones. A qualified rural opportunity fund (QROF) is a QOF holding at least 90% of its assets in rural areas. Greater tax benefits are permitted for these funds (for example, the 10% basis increase after 5 years is increased to a 30% basis increase).

(7) Reporting. Heightened reporting requirements apply under the Act.

A possible disadvantage of waiting to make a QOZ investment is that an opportunity to make an investment in property located in a current opportunity zone may not qualify after the zones have been re-designated. However, under the Act, currently designated tracts will remain eligible through 2028. The gain deferral advantage is basically nonexistent until 2027 (though an investment in a qualified opportunity fund in 2025 could achieve a one-year deferral of existing gain). If an individual wants to sell stock but would like to take advantage of the gain deferral advantage of a QOF, the stock could be hedged to protect its value until 2027 when it could be sold, and the amount of the capital gain could be invested in a QOF.

For further discussion of QOFs under the 2017 Act, see Item 29 of Estate Planning Current Developments and Hot Topics (Dec. 2019) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

u. **Miscellaneous New Tax Cuts and Policies.**

Observe that the first four of these items described below apply **beginning in 2025** but only through 2028. Those first four items are "above-the-line" deductions (meaning they apply even for taxpayers who use the standard deduction). The combined tax benefit of these four items will primarily benefit taxpayers with $100,000 to $500,000 of income (42.1% for $100,000 - $200,000 income levels and 31% for $200,000 - $500,000 income levels). *Combined Tax Benefit of the Deductions for Qualified Tips, Overtime Compensation, Vehicle Loan Interest and the $6,000 Deduction for Seniors*, URBAN-BROOKINGS TAX POLICY CENTER (AUG. 4, 2025).

(1) **Deduction for Tip Income.** The Act provides in new §224 an above-the-line deduction of up to $25,000 for qualified tips (generally cash tips received by an individual in an occupation which traditionally and customarily receives tips) for 2025-2028. The deduction phases out by $100 for each $1,000 by which the "modified adjusted gross income" exceeds $150,000 ($300,000 for joint returns). ($39.1 billion five-year cost). Individuals who already have no taxable income

because of the standard deduction will see no benefit from this measure; "it is more of a middle-income benefit, not a low-income benefit." Regulations will be essential for details. ($32 billion five-year cost)

The Treasury and IRS released proposed regulations (REG-110032-25) on September 19, 2025, providing details on the occupations and forms of gratuities that qualify for the tip income deduction. The proposed regulations include the same 68 occupations that were in the preliminary list released on September 2, 2025. The occupations are grouped into eight categories: beverage and food service, entertainment and events, hospitality and guest services, home services, personal services, personal appearance and wellness, recreation and instruction (for example, including hot air balloon aeronauts and skydiving pilots), and transportation and delivery.

To claim the deduction, a worker must both be in an occupation on the list and receive qualified tips. The proposed regulations have various rules for what constitute qualified tips.

- They must be paid in cash or an equivalent medium (including most digital assets denominated in cash).
- They must be received from customers, or for employees, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool.
- They must be paid voluntarily and not subject to negotiation. For example, an automatic 18% service charge for large parties would not qualify.
- They must not be paid for illegal activities, prostitution services, or pornographic activity.

Notice 2025-62 provides that employers will not be subject to penalties for tax year 2025 regarding new information reporting requirements for cash tips and qualified overtime compensation. Also, the IRS has announced that Forms W-2 and 1099 for 2025 will not be updated to account for the changes made in the Act. Systems and procedures are not in place to correctly file the additional information, and 2025 will be treated as a transition period for enforcement and administration of the new information reporting requirements for cash tips and qualified overtime compensation.

(2) **Deduction for Overtime Compensation.** The Act provides in new §225 an above-the-line deduction of up to $12,500 ($25,000 for joint returns) for qualified overtime compensation (as described in section 7 of the Fair Labor Standards Act of 1938) for 2025-2028. The deduction phases out the same as for tip income (described immediately above). ($90 billion 5-year cost)

(3) **Deduction for Seniors.** The Act grants a new §151(d)(5)(C) an addition of $6,000 ($12,000 for joint returns) to the standard deduction for seniors (age 65 and above) for 2025-2028, with a phase-out of 6 percent of the modified AGI in excess of $75,000 ($150,000 for joint returns). ($71.6 billion five-year cost) (This is added in lieu of excluding Social Security from gross income, because that could not be included in reconciliation legislation.)

(4) **Deduction for Car Loan Interest.** The Act allows in new §163(h)(4) an above-the-line deduction of up to $10,000 for qualified passenger vehicle loan interest during any year from 2025-2028. This applies to new vehicles for which the final assembly occurs in the United States. The deduction phases out by $200 for each $1,000 by which the "modified adjusted gross income" exceeds $100,000 ($200,000 for joint returns). Proposed regulations under §163 and §6050AA were issued Dec. 31, 2025, regarding the car loan interest deduction. REG-113515-25 (Dec. 31, 2025).

(5) **Draft of Schedule 1-A For Reporting New Deductions.** The IRS on September 8, 2025, released a draft of Schedule 1-A to report claimed deductions for tip income, overtime compensation, and car loan interest and to report the senior deduction. *See* Mary Katherine Browne, *IRS Unveils New Draft Schedule for OBBBA Deductions*, 188 TAX NOTES FEDERAL 2048 (Sept. 22, 2025).

(6) **Trump Accounts.** The provision for Trump accounts in the House-passed bill was dramatically changed by the Senate to turn it into a type of IRA account that could be funded for persons under age 18. New §530A provides for the creation of "Trump accounts," which are IRA accounts other than Roth IRAs and that meet specified requirements for persons under age 18 for whom an election is made and allows parents, relatives, employers, charities, or nonprofits to contribute up to an aggregate of $5,000 per year (indexed for inflation) to the accounts until age 18.

In addition, under new §6434 the U.S. government will contribute $1,000 to Trump accounts for babies who are U.S. citizens born during 2025 through 2028 and have been assigned Social Security numbers and for whom an election is made. There is no income criteria. (About 3.6 million babies are born in the U.S. annually.) Penalties apply under new §6659 for improper claims for such contributions. Details for funding or the creation of new accounts for babies will be provided by future guidance.

Highlights about Trump accounts include the following.

- Like other IRA accounts, income of the account is not taxed annually.
- Funding of the accounts cannot begin until at least 12 months after the date of enactment (i.e., until after **July 4, 2026**). Details about how accounts will be opened and funded and about which financial institutions will offer Trump accounts will come in future guidance.
- Contributions before January 1 of the year the child turns 18 are nondeductible, and contributions are not includible in the beneficiary's gross income.
- Funds provided to Trump accounts by employers, up to $2,500 per year (which is adjusted for inflation and which counts against the $5,000 annual limit; the $2,500 amount is per employee, not per minor), will not be taxable income (§128).
- Funds must be invested in low-cost stock index mutual funds or ETFs only with no leverage; annual fees and expenses of the investment cannot exceed 0.1 percent; the funds must rack the S&P 500 or another index of primarily American equities.
- No withdrawals are permitted before the first day of the calendar year the beneficiary reaches age 18 except for rollovers to ABLE accounts, corrections of excess contributions, or death or disability.
- After January 1 of the year the child turns age 18, the traditional IRA rules under §408(a) apply.
- After that time, the child may make withdrawals from the account. Withdrawals are taxed under traditional IRA rules; they are taxed as ordinary income and such withdrawals before age 59½ are subject to a 10% penalty (but the 10% penalty does not apply for certain early withdrawals, such as for a first-time home purchase, qualified educational expense, disability, and certain medical expenses). (A change from the House to the Senate version is that there is no exception for taxing withdrawals for higher education, first-time home purchase or starting a business at long-erm capital gains rates.)
- There is no required minimum distribution for these accounts (though that could certainly change legislatively by the time the child reaches the age for which RMDs generally apply for IRAs).
- The Act does not address whether gifts to a Trump account qualify for the gift tax annual exclusion. They are not gifts of a present interest, so presumably, they would not qualify for the annual exclusion, and any donor to a Trump account would have to file a gift tax return to report any such gift.
- Because the accounts are treated under the traditional IRA rules after the minor reaches age 18, most planners believe that the account could be converted to a Roth account. For example, the conversion might be done after the minor is no longer a dependent (so the income from the Roth conversion is not reported at the parents' rates), but when the child is

still in a low income tax bracket. The Roth conversion option makes these accounts viable alternatives for building a retirement fund for minors; the investment from the $5,000 annual contributions could accumulate to a significant amount by age 18, and following the Roth conversion, the amount could continue to grow tax-free and would not be subject to income tax when it is withdrawn following retirement.

The IRS announced in Notice 2025-68 that it intends to propose regulations regarding Trump Accounts. The Notice provides a general overview of Trump accounts, addresses certain specific initial questions about Trump accounts, and requests comments. The draft Form 4547, "Trump Account Election(s)," and its draft instructions were released on Dec. 3, 2025, a day after Notice 2025-68 was posted.

The election may be made with Form 4547 or by using an online portal that will be available sometime in mid-2026 at **www.trumpaccounts.gov**.

Michael and Susan Dell have pledged to donate $6.25 billion to Trump accounts, which will include $250 for qualifying U.S. citizen babies born during 2025 through 2028 and for children age 10 and under living in Zip Codes with median incomes below $150,000.

Treasury Secretary Bessent has suggested that Trump Accounts could lead to the eventual privatization of Social Security. He stated: "In a way, it is a backdoor for privatizing Social Security. If all of a sudden these accounts grow and you have in the hundreds of thousands of dollars for your retirement, then that's a game changer." Alexander Rifaat, *Bessent: 'Trump Accounts" Pathway to Privatizing Social Security*, 188 TAX NOTES FEDERAL 835 (Aug. 4, 2025).

(7) **529 Account Enhancements.** Section 529 savings plans have more favorable tax treatment than Trump accounts. As long as the funds are used for qualified education purposes, no tax applies when the proceeds are withdrawn from 529 accounts.

The Act makes significant helpful enhancements for 529 accounts: (1) the list of eligible education expenses is expanded (applicable for distributions after the date of enactment); (2) the annual limit for 529 account distributions for K-12 expenses (expanded beyond just tuition costs) is increased from $10,000 to $20,000 (applicable for tax years after 2025); and (3) "qualified postsecondary credentialing expenses" are added as exempt distributions (applicable for distributions after the date of enactment).

(8) **Increased Excise Tax on Colleges and Universities.** The Act increases the existing 1.4% excise tax on the net investment income of private colleges and universities if they have large endowments.

The new law applies to schools that enroll at least 3,000 students, up from the 500-student threshold set in the TCJA, which first imposed an endowment tax. International students are no longer excluded from the student count for that test.

The excise tax rates for particular endowments per student would be: 1.4% ($500,000-$749,999), 4% ($750,000-$1,999,999), 8% (over $2,000,000). The 8% rate would apply to Yale, Harvard, Princeton, Stanford, and MIT (listed in the order of their estimated excise tax, ranging from about $176 million to $81 million). The 4% rate would apply to Notre Dame, University of Pennsylvania, Emory, Washington University in St. Louis, Vanderbilt, Rice, Dartmouth College, and the University of Richmond (listed in the order of their estimated excise tax, ranging from about $32 million to $6 million). *See* Katie Lobosco, *13 Colleges Could Face Endowment Tax Hike Under OBBBA*, TAX NOTES TODAY (Sept. 24, 2025). International students are included in making the endowment per student calculation (a change from the House version). Universities have responded that this is essentially a tax on national research and student aid. The House version would have applied much higher excise taxes (21% for the highest tier). A provision to exclude religious institutions from the higher tax was deemed extraneous by the Senate Parliamentarian and was removed (and may result in Notre Dame being subject to the increased excise tax).

Receiving much less attention is that the Act also expands the definition of net investment income for this purpose to include (1) interest income paid on institutional loans the school made to its students and (2) federal subsidized royalty income (including proceeds from any patent,

copyright, or other intellectual or intangible property that result from the work of students or faculty members that used federal money to fund their research, and there appears to be no limit on how long ago or how little the federal funding was). *See* Katie Lobosco, *OBBBA Subjects More Income Types to Endowment Tax*, 188 TAX NOTES FEDERAL 968 (Aug. 11, 2025).

The American Enterprise Institute estimates that 20 institutions will be subject to the endowment tax next year. Yale's president recently indicated that Yale would pay about $280 million next year. The American Enterprise Institute estimates that the endowment tax next year for several universities will be $368 million for Harvard, $217 million for Princeton, and $202 million for Stanford. It estimates that those four schools and MIT, could *each* pay more than **$1 billion** over the next five years. Various other universities may cross the $500,000 assets-per-student threshold within the next five years. *See* Mark Schneider & Christopher Robinson, *How Much Will Universities Pay in Endowment Tax?*, AMERICAN ENTERPRISE INSTITUTE (July 14, 2025) (available at **https://www.aei.org/education/how-much-will-universities-pay-in-endowment-tax/**)

Interestingly, the Joint Committee on Taxation scored this provision as generating only $0.8 billion savings over the period of 2025-2034.

(9) **Not Included.** The Act does not include a provision for adding a new higher income tax bracket for high-income taxpayers (which had been suggested by President Trump), does not tax "carried interests," and does not include provisions limiting the amortization of intangible assets of sports franchises (which was in the House version).

v. **Summary of Changes Beginning in 2025; No Revisions to Withholding Tables or Information Reports for 2025; Tax Cuts for 2025.** The following changes, discussed above, apply beginning in 2025: Increased standard deduction, tip income deduction, overtime pay deduction, senior deduction, car loan interest deduction, expanded SALT deductions, child tax credit increase, Trump Accounts (beginning for children born in 2025), qualified small business stock (QSBS) relaxed requirements, and the selected business provisions.

The IRS announced that there will be no changes to certain information returns or withholding tables for tax year 2025 (even though some of the tax changes apply in 2025), including that (1) Form W-2, Form 1099, Form 941, and other payroll return forms are not updated for 2025, (2) income tax withholding tables will not be updated, and (3) employers and payroll providers should continue using current procedures for reporting and withholding. IR-2025-82 (Aug. 7, 2025).

Tax refunds are expected to be higher in the 2025 tax filing season than previously. The Act includes some tax decreases beginning in 2025 (mentioned above). Joseph Rosenberg, a senior fellow with the Urban Institute-Brookings Institution Tax Policy Center estimates that overall tax bills will go down by about $125 billion, or $650 per taxpayer. Higher income taxpayers will receive more of these benefits. About 16 percent of the bottom fifth of taxpayers by income will have tax cuts for 2025, but about 91 percent of the top fifth of taxpayers by income will see a tax cut, averaging about $2,300. (The amounts of refunds will depend on whether taxpayers adjusted their withholding amounts.) *See* Maria Briceno & Louis Jacobson, *Fact-Check: President Trump's Speech on Inflation, Wages, Military Dividend*, POLITIFACT (Dec. 18, 2025), available at **https://www.politifact.com/article/2025/dec/18/fact-checking-trump-speech-warrior-dividend/**.

5. Behind the Scenes: Background Issues of Primary Importance in the Evolution of the Act

a. **Reconciliation Legislative Process.** The Senate can pass tax legislation with a mere majority (as opposed to 60 votes required for most legislation to overcome the filibuster and bring a bill to a vote) under the reconciliation legislative process enacted in the Congressional Budget Act of 1974. That Act was used for the first half of its existence to *reduce* deficits; starting in 2001, it has been used to grow deficits more than half the times it has been used. Republicans have a majority of both the House and Senate in 2025 and passed the Act without bipartisan involvement. (Congress could pass another reconciliation act in the fall of 2025 or next year for the fiscal year beginning Oct. 1, 2025.)

The reconciliation process begins with the adoption of a budget resolution, agreed to by both the House and Senate. The budget resolution sets a "budget window" (traditionally ten years), gives

instructions to committees, and sets an overall deficit limitation. The budget resolution gives instructions to House and Senate Committees and the work of their committees is "reconciled" into a single reconciliation act for approval in the House and Senate.

b. **"Byrd Rule" Overview.** The "Byrd rule" applies in the Senate for reconciliation acts. A Senator can call point of order as to (among other things): (1) any item that does not have fiscal impact (a number of provisions in the bill were dropped after the Senate Parliamentarian ruled they did not satisfy this requirement); (2) any item affecting Social Security; or (3) if the act would increase deficits outside the "budget window" (typically ten years). That third item is the reason many reconciliation acts in the past "sunset" and reverted to the prior law at or before the end of the budget window (but the Senate was able to avoid that rule in the Act by applying a current policy baseline to the tax provisions in the Act.)

   The Senate Presiding Officer rules on points of order. The Presiding Officer receives advice from the Senate Parliamentarian (and traditionally follows the advice of the Parliamentarian). Issues will often be raised with the Parliamentarian before official points of order are raised, and offending measures are voluntarily removed from the bill. The Senate could override the ruling of the Presiding Officer on a point of order, but 60 votes are required to waive points of order or to successfully appeal the ruling of the Presiding Officer on a point of order under the Byrd rule. Congressional Budget Act §904(d).

c. **Brief History of Adoption of Budget Resolution and the Act.** The initial Senate budget resolution (adopted Feb. 21, 2025) only addressed border security and defense, while the House version also addressed taxes. The initial House budget resolution was adopted Feb. 25, 2025, by a vote of 217-214 (Rep. Thomas Massie (R-KY) was the only Republican to vote against the resolution). The Senate voted 51-48 to adopt an amended version of the budget resolution on April 5, 2025. The amended Senate resolution adopted the novel approach of empowering the Chair of the Senate Budget Committee (Lindsey Graham (R-SC)) to determine the baseline for scoring the legislation, The House voted 216-214 on April 10 to adopt the Senate amended version of the budget resolution (Reps. Thomas Massie (R-KY) and Victoria Spatz (R-IN) voted against the resolution).

   The House Ways and Means Committee released marks of the bill on May 9 and May 12 and approved its tax portion of the reconciliation package following a 17-hour markup session on May 13. The House Budget Committee compiled the work of 11 House committees into a single bill. The House Budget Committee rejected the bill on May 16, 2025, by a vote of 21-16 when four budget hawks (Reps. Chip Roy (R-TX), Josh Brecheen (R-OK), Andrew Clyde (R-GA), and Ralph Norman (R-SC)) voted against the bill because it did not make enough spending cuts or slash tax benefits to low-income households (one Republican who supported the bill voted no so the bill could be reconsidered). On May 18, 2025, the House Budget Committee approved the reconciliation package (officially titled the "One Big Beautiful Bill Act," but the official title was removed in the Senate on advice from the Parliamentarian that the title violated the Byrd rule because it did not have fiscal impact) in a 17-16 party-line vote, with four conservatives voting "present" (the same four that voted against the bill on May 16). The House Budget Committee could not make changes to the bill, but assurances were made that changes would be made by the House Rules Committee, which could make changes to the bill. The House Rules Committee began its markup of the reconciliation bill at an unusual hour—1 a.m. on May 21, 2025. The committee session stretched over 21 hours as leaders worked to reconcile differences between moderate and conservative factions, resulting in a 42-page Manager's Amendment which was approved by the Rules Committee after enough votes for passage, especially from holdouts concerned about issues like the state and local tax (SALT) deduction cap and work requirements for social programs. The markup ended after 10:30 p.m.

   The House began acting immediately after the bill was advanced from the House Rules Committee. After an all-night session, the bill narrowly passed at 6:45 a.m. on May 22 by a vote of 215-214, with two Republicans casting no votes (Rep. Thomas Massie (R-KY), who has consistently voted against the measure because it produces additional deficits, and Rep. Warren Davidson (R-OH)) and one Republican, Rep. Andy Harris (R-MD), voting present (because he wanted to move the legislation along but had concerns about deficits and Medicaid). Two other Republicans failed to vote (Rep. Andrew Garbarino (R-NY) fell asleep and missed the vote), but they supported the bill.

Negotiations in the Senate included resolving differences among those concerned that the act would add too much to deficits and those that were concerned that spending cuts (particularly to Medicaid and nutrition programs) were too severe. Negotiations among Senators resulted in a wide variety of changes to the bill as approved by the House. A procedural vote in the Senate to move the legislation forward for formal consideration by the Senate was approved on June 28, 2025, after voting was held open for about three hours to obtain the necessary votes. Sens. Rand Paul (R-KY), Thom Tillis (R-NC), and Ron Johnson (R-WI) initially voted no while four other senators withheld their votes. Ultimately, the procedural measure passed 51-49, with Sen. Ron Johnson changing to vote in favor of the measure. The Senate approved the Act in the morning of July 1 by a vote of 51-50 (with the Vice-President voting to break the tie vote). Three Republicans voted against the bill: Sens. Rand Paul (R-KY), Thom Tillis (R-NC), and Lisa Murkowski (R-AK). (A number of special provisions "for non-contiguous states" had been added as a sweetener for obtaining Sen. Murkowski's vote.) The changes in the Senate increased the reduction of net federal revenues from $3.8 trillion to $4.475 trillion for 2025-2034 and increased the addition to deficits from $2.8 trillion to $3.39 trillion (those numbers do not include additional interest that would be paid on the additional national debt). *Estimated Budgetary Effects of Public-Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline As Enacted on July 4, 2025*, CONGRESSIONAL BUDGET OFFICE (July 21, 2025).

The House approved the Act on July 3 by a vote of 218-214, with two Republicans voting against the bill (Reps. Thomas Massie (R-KY) and Brian Fitzpatrick (R-PA)). Various Republican representatives who were upset with changes made by the Senate ultimately decided to vote for the legislation, apparently with assurances that future legislation or executive orders would address some of their concerns. President Trump signed the bill into law on July 4, 2025.

d. **Costs; Dynamic Revenue Effect.** The cost and savings estimates listed below are over the 10-year budget window (2025-2034).The Joint Committee on Taxation has estimated that the Senate-passed amended version of the bill cuts taxes by **$4.475 trillion** dollars over ten years compared to present law (up from $3.8 trillion under the House-passed version) and cuts taxes by **$715.2 billion** dollars over ten years using a current policy baseline. *Estimated Revenue Effects of a Manager's Amendment to the Tax Provisions to Provide Reconciliation of the Fiscal Year 2025 Budget in the Senate Relative to Present Law,* JCX 31-25, JOINT COMMITTEE ON TAXATION (Jan. 28, 2025)*; Estimated Revenue Effects of a Manager's Amendment to the Tax Provisions to Provide Reconciliation of the Fiscal Year 2025 Budget in the Senate Relative to Current Policy,* JCX 30-25, JOINT COMMITTEE ON TAXATION (Jan. 28, 2025). Those numbers are each about $250 billion higher than estimates made by the Committee a week earlier because of additional tax cuts that were added into the package during that week (including about $180 billion of added cuts for SALT deductions and $34 billion of additional cuts for expanded Opportunity Zone investments).

The Congressional Budget Office (CBO), on July 21, 2025, updated its prior estimates and concluded that the Act as enacted would increase primary deficits and add to the national debt **$3.39 trillion** *Estimated Budgetary Effects of Public-Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline As Enacted on July 4, 2025*, CONGRESSIONAL BUDGET OFFICE (July 21, 2025). (A prior June 27, 2025 CBO report also concluded that the Senate bill cut about $300 billion in food stamp spending and $1 trillion from Medicaid and health care and "would increase by 11.8 million the number of people without health insurance in 2034." The July 21, 2025 report revised the 11.8 million number to 10 million.)

A letter from the CBO Director dated August 4, 2025, summarized the viewpoint of the CBO and the Joint Committee on Taxation that the Act would increase deficits over the 2025-2034 period by $3.394 trillion, excluding any macroeconomic or debt-service effects, and will increase debt-service costs by $718 billion over that period, resulting in a cumulative effect on deficits of **$4.113 trillion**. If the 10 temporary provisions in the Act are made permanent primary deficits over that period would be increased by an additional $0.8 trillion, and total debt-service costs would total $789 billion, resulting in cumulative effect deficits of **$5.0 trillion**. Letter from CBO Director, Phillip L. Swagel to Rep. Jeff Merkley (Ranking Member of Senate Committee on the Budget (August 4, 2025).

The Committee for a Responsible Federal Budget had previously estimated that the additional interest on the added debt would add about $690 billion, resulting in an overall cost of **$4.1 trillion**. It also estimates that if all the expiring provisions in the Act were made extended for a full ten years, the cost (including additional interest) would be increased to about $5.5 trillion. *15 Major Problems with the Senate Reconciliation Bill*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (July 2, 2025).

In high contrast with those estimates, the White House Council of Economic Advisors predicts that the One Big Beautiful Bill Act will generate "$2.1 to $2.3 trillion in offsetting deficit reduction due to higher growth from the OBBBA provisions" and "$1.3 to $3.7 trillion in additional offsetting deficit reduction from higher growth unleashed by OBBBA enhanced deregulation and energy practices." Furthermore, it estimates "$8.5 to $11.1 trillion in total offsetting deficit reduction from Trump economic policies anchored by the OBBB, including discretionary spending reductions and tariff revenue." *The One Big Beautiful Bill: Legislation for Historic Prosperity and Deficit Reduction*, at 1, THE COUNCIL OF ECONOMIC ADVISERS (June 2025). The Report concludes:

> The CEA finds that the OBBB will cause investment to surge, GDP to rise, and paychecks to fatten as Americans receive higher wages and keep more of the money they earned. Left-behind Americans and overlooked communities will experience a new era of rising fortunes as the overall economic environment improves and as private-sector driven growth unleashed by policies in the OBBB spreads to every corner of America. Critically, the CEA estimates that the OBBB and the broader Trump economic policies that it supports will bend the trajectory of debt downward ….

Id. at 14.

Economists generally do not agree with the White House that the Act will have large positive dynamic effects. The Congressional Budget Office analysis of the dynamic macroeconomic effects of the initial House-passed version of the bill was that the primary deficits over the budget window would *increase* by $356 billion from $2.4 trillion to $2.8 trillion as a result of economic effects. It concluded that additional debt from interest rate increases that would occur because of the Act would be greater than the reduction of deficits from future growth. *Congressional Budget Office Dynamic Estimate* (June 17, 2025).

The Joint Committee on Taxation on May 22, 2025, estimated that the macroeconomic effects of the tax package as reported by the House Ways and Means Committee on May 12, 2025, would be only $102.8 billion over 10 years (far less than the $2.6 trillion additional revenue from growth assumptions in the House budget resolution).

The Penn Wharton University of Pennsylvania Budget Model estimates that the economic dynamic impact of the reconciliation package passed by the House will actually *increase* deficits during the budget window of 2025-2034 (from $2.787 trillion to $3.198 trillion), because savings from economic growth do not appear until 2033 and 2034.

Some have responded to the economic estimates of the CBO and Joint Committee on Taxation by criticizing them. For example, Republican leaders have argued that the CBO underestimated by $1.5 trillion how much revenues would grow under the 2017 TCJA from 2018 through 2024. However, federal revenue collections were actually lower in the two years following the TCJA implementation and an unexpected revenue surge occurred in 2022. *See* Katie Lobosco, *Congress Races to Extend TCJA Without Knowing Its True Impact*, 187 TAX NOTES FEDERAL 920 (May 5, 2025). The CBO acknowledges the $1.5 trillion underestimation but blames $900 billion of the underestimate on higher than expected inflation and much of the rest on unexpectedly high tariff revenues not included in the original projection. *See id.*; Doug Sword, *Top House Taxwriter Calls Current-Policy Approach 'a Fraud,'* 186 TAX NOTES FEDERAL 1129 (Feb. 10, 2025). The Committee for a Responsible Federal Budget says the data show that all the additional $1.5 trillion revenue can be explained either by higher inflation or by a temporary one-time post-pandemic revenue surge in 2022—"the fifth year after passage of the TCJA and immediately on the heels of a pandemic and inflation crisis." *Has TCJA Paid For Itself?*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Jan. 22, 2025).

Various members of Congress have made very strong statements about not adding to deficits. In explaining why they voted for the House budget resolution, some Representatives spoke of assurances that the final bill would not add to deficits. House Budget Committee Chair Jodey C. Arrington (R-TX) said that what was most important to him was "a commitment from the leadership of the House that we will not put a bill on the floor of our chamber that adds to the national debt." Rep. Arrington stated that "increasing the deficit … would be a nonstarter for a good number of members of the House" and that members who would object are "well beyond our vote margin … probably in the double digits for sure." Doug Sword & Cady Stanton, *Those Troublesome Budget Instructions: They Might Not Matter*, 187 TAX NOTES FEDERAL 767 (April 28, 2025). House Freedom Caucus Chair Andy Harris (R-MD) also reiterated the importance of reassurances that the bill will not increase the deficit and "getting assurances, both from the Senate and the House leadership, that that's not going to happen." Following passage of the House bill, Sen. Ron Johnson (R-WI) on May 22, 2025, warned: "I couldn't care less if [President Trump]'s upset. … We are stealing from our children and grandchildren. Thirty-seven trillion dollars of debt and we are going to add to it as Republicans? That is unacceptable. That's why there's no way I'm going to vote for this bill in its current form." On May 25, 2025, on "CNN Face the Nation," Sen. Johnson said "This is our only chance to set [spending levels] back to that pre-pandemic level of spending…. I think we have enough [objecting senators] to stop the process until the president gets serious about spending reduction and reducing the deficit." *See* Catie Edmondson & Minho Kim, *Fiscal Hawks in Senate Balk at House's Bill to Deliver Trump's Agenda*, NEW YORK TIMES (May 25, 2025).

e. **National Debt, Deficits, Interest Payments.** The national debt has grown from $4.6 trillion in 2005, to $13.1 trillion in 2015, to $34 trillion in January 2024, to $35 trillion in July 2024, to $36 trillion in November 2024, and to $37 trillion in August 2025. The Joint Economic Committee estimates the national debt will grow by another trillion dollars in approximately 173 days. Michael Peterson (Chair and CEO of the Peter G. Peterson Foundation says "We are now adding a trillion more to the national debt every 5 months. That's more than twice as fast as the average rate over the last 25 years." *U.S. National Debt Reaches a Record $37 Trillion, the Treasury Department Reports*, NBC NEWS (Aug. 12, 2025).

The national debt is currently 100% of GDP, and the Congressional Budget Office estimates it will grow (even if the TCJA were not extended) to 107% of GDP in 2029 (the highest percentage of GDP it has ever been), to 118% of GDP in 2035, to 156% of GDP in 2055. It would grow to 214% of GDP in 2055 if the TCJA is extended. Jack Lew, Secretary of the Treasury in the Obama administration, observes: That would put us in the company of Sudan—hardly a fiscal badge of honor." Jack Lew, *GOP Tax Bill Will Hurt the Vulnerable and the Deficit*, BLOOMBERG DAILY TAX REPORT (June 10, 2025).

In January 2025, the CBO estimated that the annual deficit for FY 2025 is $1.9 trillion and is expected to grow to $2.7 trillion by 2035. The Budget and Economic Outlook 2025 to 2035, CONGRESSIONAL BUDGET OFFICE (January 2025). The deficit for FY 2025 (Oct. 1, 2024 to Sept. 30, 2025) is $1.8 trillion. *Monthly Budget Review: September 2025*, CONGRESSIONAL BUDGET OFFICE (Oct. 8, 2025). The national debt may grow by about $22 trillion in ten years even before considering the impact of the Act.

Part of the deficit is from additional spending attributable to the aging of America; Social Security expenditures saw an increase of 9%, or $108 billion, over the first 10 months of FY 2025 to $1.368 trillion. *See* David Lawder, *US Deficit Grows to $291 Billion in July Despite Tariff Revenue Surge*, REUTERS (Aug. 12, 2025).

The Committee for a Responsible Federal Budget estimates that the national debt held by the public will grow by $23 trillion by 2035 (and that the annual deficit will grow to $2.6 trillion and the net interest payment will grow to $1.8 trillion in 2035). *An August 2025 Budget Baseline*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Aug. 20, 2025).

Deficits are persistent despite the substantial additional tariff receipts. For example, customs duties (including tariffs) jumped from about $77 billion in FY 2024 to an estimated $195 billion in FY 2025, an increase of $118 billion. *Monthly Budget Review: September 2025*, CONGRESSIONAL BUDGET

OFFICE (Oct. 8, 2025). *See* Daniel Flatley, *US Deficit Tracks Third-Highest Ever Even as Tariff Take Rises*, BLOOMBERG DAILY TAX REPORT (Sept. 11, 2025).

Interest on the national debt has grown from $345 billion in 2020, to $704 billion in 2023, to $950 billion in 2024. Interest on the public debt continues to increase, topping $1.01 trillion for the first ten months of FY 2025, an increase of 6%, or $57 billion, over the same prior year period due to slightly higher interest rates and increased debt levels. *See id*. Interest on the public debt is now the second largest federal expenditure, second only to Social Security. It exceeds federal spending on defense.

Ferguson's Law, named after English historian Sir James Ferguson, suggests that a civilization begins to decline when its interest expense (debt repayments) exceeds its defense expenditure. It argues that when a society's financial obligations to debt holders become so overwhelming that they surpass the funds needed to defend the society, the civilization is likely to face significant decline or collapse. Historical examples are ancient Egypt, the Roman Empire, the Spanish empire of the 17th century, the British Empire in the 19th and 20th centuries, and the Soviet Union.

Some "budget hawks" in Congress are genuinely concerned about deficits and the growing national debt (but most of the Republican "budget hawks" voted for the Act).

Some economists maintain that the high national debt levels will lead to increased inflation. The very high levels of national debt leads to high annual interest payments on the debt, which will lead to pressure on the Federal Reserve to reduce interest rates to maintain the government's solvency. That increases the money supply, which leads to higher inflation.

> The government currently pays an average interest rate of 3.4% on its debt. But 3.4% on $37 trillion is a whopping $1.2 trillion per year. To put that in perspective, each year, debt interest costs the federal government 1 1/2 times what the entire Department of Defense costs.
>
> The debt has become so large that small changes in interest rates now have massive implications. Just a one percentage point increase in interest rates eventually would cost the federal government an additional $400 billion per year in interest expense. …
>
> This has dire implications for monetary policy. The Federal Reserve has two goals: maintaining full employment and keeping prices stable. The government's debt is causing a third goal to emerge: maintaining the government's solvency.
>
> As the debt grows, this third goal will overshadow the other two, forcing monetary policy to conform to fiscal policy. The Fed gradually will cease to be a stabilizing hand on the economic rudder as it's forced to become the government's ATM. This means that low inflation will be a thing of the past.
>
> Inflation is already running a full percentage point above its pre-Covid average. Increased government borrowing will put upward pressure on interest rates. To alleviate that pressure, the Fed will cut short-term rates. That will cause the money supply to grow, and that will push inflation higher.
>
> Americans should expect long-term rates to remain elevated, and they should get used to a new normal of elevated inflation.

Antony Davies & James Harrigan, *'Deficit Day' Is No Cause to Celebrate as Spending Exceeds Taxes*, BLOOMBERG DAILY TAX REPORT (Sept. 22, 2025).

As a practical matter, deficit reduction will likely require a bipartisan effort because it requires painful changes. Balanced budgets were the result of bipartisan agreement during the Clinton administration in 1998-2001. "Real deficit reduction requires compromise and shared pain—some combination of cutting spending and raising revenues. Bipartisan cooperation is the only way to share the political pain as well." Jack Lew, *GOP Tax Bill Will Hurt the Vulnerable and the Deficit*, BLOOMBERG DAILY TAX REPORT (June 10, 2025). Mitt Romney shares this view. He observes that "[t]typically, Democrats insist on higher taxes, and Republicans insist on lower spending. But given the magnitude of our national debt as well as the proximity of the cliff, both are necessary." Mitt Romney, *Mitt Romney: Tax The Rich, Like Me*, NEW YORK TIMES (Dec. 19, 2025). He recommends tax increases involving

these issues: removing basis adjustment at death for mega-estates over $100 million, 1031 exchanges, rapid real estate depreciation deductions, state and local tax deductions, the tax rate on carried interest, estate tax charitable deduction limitations for the largest estates, and increasing the income level on which FICA employment taxes are applied. *Id.*

f. **Current Policy Baseline.** The Senate adopted the novel approach (never before used in any reconciliation legislation) to measure the fiscal impact of the Act using a "current policy" baseline (which assumes that the current tax rates or provisions continue indefinitely). The Senate budget resolution empowered the Chair of the Senate Budget Committee (Lindsey Graham (R-SC)) to determine the baseline for scoring the legislation under the authority of section 312 of the Congressional Budget Act of 1974, which says budgetary levels "shall be determined on the basis of estimates made by the Committee on the Budget of the House of Representatives or the Senate, as appropriate." In contrast, legislation is typically scored under a "current law" approach (for example, it would assume that the tax system would revert to its pre-TCJA state as is called for under current law).

The key reason for using the current policy baseline is that it ostensibly would allow the TCJA to be extended permanently despite the Byrd rule (because the system currently in effect is the baseline for judging the fiscal impact of the act). See Item 5.g below regarding whether the current policy baseline approach can be used for purposes of applying the Byrd rule.

Some members of the House and Senate viewed using a current policy baseline as "intellectually dishonest" and "magic math." Republican leaders countered that spending levels are assumed to continue in scoring legislation so making the same assumption for revenue levels would be consistent, but commentators point out that spending appropriations that are specifically limited in time are not assumed to continue indefinitely under the scoring rules. Even if the current policy baseline assumes no revenue impact, the Act still increases deficits over ten years by about $4 trillion. Senate Finance Committee Chair Mike Crapo (R-ID) promised in an April 4, 2025, floor speech that the traditional scoring method (showing larger deficit increases) would be published as well, because it would reflect how big the tax savings are for Americans.

The Congressional Budget Office and the Joint Committee on Taxation are required to "score" fiscal bills using a current law baseline approach. The current policy baseline approach has never been used for a reconciliation act. Section 257 of the Balanced Budget and Emergency Deficit Control Act defines the baseline using a current law approach. The current policy approach taken by the Senate, was taken under the authority in section 312 of the Congressional Budget Act, which authorizes the Chair of the Senate Budget Committee to "estimate" fiscal impacts. That is novel for reconciliation legislation and could dramatically change how reconciliation legislation is used in the future. Shortly after the Senate leadership announced that it would use the current policy baseline under the authority of section 312, other Senators argued that this novel approach was inappropriate under existing law.

> [I]t has been asserted this week that under section 312 of the Congressional Budget Act, the chair of the Budget Committee has the authority to instruct the Congressional Budget Office, known as CBO, and the Joint Committee on Taxation, known as JCT, to ignore budget law when developing cost estimates for legislation, including budget reconciliation bills. It has further been asserted these directed estimates are appropriate to use for budget enforcement purposes claiming that past Budget chairs have taken similar actions. This is false.
>
> I would like to put some facts into the record. Section 257 of the Balanced Budget and Emergency Deficit Control Act defines how CBO and JCT should construct the baseline. This is called the current law baseline…. For 40 years, Congress has used cost estimates based on section 257 of this act. Codifying a baseline established a standard budget enforcement regime, ensuring that CBO and the Office of Management and Budget use the same baseline definition when developing their respective economic forecasts and budget projections…. The section 257 current law baseline has applied to all reconciliation bills since its enactment.

Statement of Sen. Jeff Merkley (D-OR) on Senate floor, 171 CONGRESSIONAL RECORD at S2340 (April 4, 2025).

Under the reconciliation process, the budget resolution, in setting the limit on the amount by which deficits may be increased under the act, conceivably could direct that the deficits be calculated for purposes of that limit using current policy as a baseline (although that has never been done before with reconciliation legislation). Whether that would be effective for applying the Byrd rule has been unknown.

Republicans have pointed to prior uses of a current policy approach, but those have never been used in a reconciliation package and generally have just been used rhetorically to defend legislation rather than being used for official scoring of legislation. The Obama administration promoted the current policy baseline rhetorically to defend extending the Bush tax cuts that were set to expire at the end of 2012, arguing that the extension should be measured against current policy, not the "current law" under which tax cuts would expire. However, the Congressional Budget Office and the Joint Committee on Taxation used the current law baseline for scoring the legislation, as required by congressional rules. The Obama administration and some lawmakers merely highlighted the current policy perspective to justify the compromise. The Obama administration did that to highlight that they were raising revenue compared to current policy by increasing income taxes on wealthy taxpayers by allowing certain tax cuts to expire.

For an interesting discussion of the historical uses of the current policy baseline for scoring the economic impact of legislation, see Patrick Driessen, *Senate OBBBA Deficit Denial Was Decades in the Making*, 186 TAX NOTES FEDL. 2013 (Dec. 22, 2025).

g. **Current Policy and the Byrd Rule.** The Byrd rule allows senators to object to provisions in an Act that cause deficits under the Act beyond the budget window. The current policy baseline approach is designed to thwart that limitation—and it worked. How did that happen?

Soon after the Senate leadership announced its intention of using the current policy baseline under the authority of section 312, other Senators pointed out how inappropriate that was for purposes of applying the Byrd rule.

> Section 313 of the Congressional Budget Act—colloquially referred to as the Byrd Rule—is also in statute. The Byrd Rule provides strict guardrails on what is, or is not, appropriate for inclusion in a reconciliation bill. During adoption of the Byrd Rule in 1985, floor debate indicates it was understood that the Parliamentarian would advise on Byrd Rule violations, and the Senate would vote accordingly; a role for the Budget chair was not mentioned, even by the author and namesake of these constraints—Senator Robert C. Byrd.
>
> Since the Byrd Rule's adoption, it has been long-accepted practice—accepted by both sides of the aisle—to rely on the Parliamentarian to advise the chair on reconciliation privilege and enforcement issues, including evaluating compliance with Byrd Rule tests that all hinge on the scores of the provisions. Section 312 authority has never been asserted to allow the Budget chair to dictate scores to enforce or manipulate the Byrd Rule. The Senate has always relied exclusively on CBO and JCT scores when evaluating the Byrd Rule, and CBO and JCT have always relied on the section 257 current law baseline to produce those scores.
>
> Reconciliation is one of the Senate's few privileged, fast-track mechanisms for passing legislation, particularly legislation of substantial size and scope. The Budget Act grants the Senate this targeted exception from its standard of open debate and cloture protection with an expectation that there will be limitations. The inappropriate assertion that broad authority under section 312 of the Congressional Budget Act allows a Budget chair to ignore budget law, upend multiple layers of procedure, and undermine the Parliamentarian's role, is a clear violation of the Byrd Rule and the Senate precedent around reconciliation limits.

Statement of Sen. Jeff Merkley (D-OR) on Senate floor, 171 CONGRESSIONAL RECORD at S2340-2341 (April 4, 2025).

Sen. Sheldon Whitehouse (D-RI) explained that the Democrats planned to obtain a ruling from the Parliamentarian despite the attempt to end run the Parliamentarian regarding the application of the current policy approach for purposes of enforcement of the Byrd Rule.

> [Since using the nuclear option to put their people on the Supreme Court], it has been: We will never, never, never, never, never, never blow up the filibuster. We will never use the nuclear option.

> Well, here is where we are with the Parliamentarian right now: They have done an end run around getting a determination on whether this stunt that they are pulling by pretending that these tax cuts don't have any economic effect and don't add to the debt will get reviewed by the Parliamentarian.
>
> …
>
> How do you get that by the Parliamentarian? It is very hard to do, so they skip. But the problem is that sooner or later, there will be a parliamentary ruling. Maybe they hope that they have so much steam built up that the Parliamentarian will just roll over or maybe this whole thing just blows up and the Parliamentarian says: No, you can't do that. You have a lie and its own rebuttal in the exact same document. You can't pretend this is a true thing.
>
> Therefore it is not compliant with the budget laws ….
>
> So what does that mean? That means that at some point, the time will come when the Parliamentarian says "nope" and blows the whistle. They think that that is going to happen already, which is why they are doing the end run. When the day comes and it actually happens, that is when they will have to go to the nuclear option because otherwise this all will have been in vain. So we are on a path to the nuclear option. …
>
> …
>
> … When there are budget rules that we have honored for decades, they are going to ignore them. Just blow it through. There is the end run around the Parliamentarian, folks. Then at the end, they go nuclear after saying: We would never, never, never, never, never, never do that.

Statement of Sen. Sheldon Whitehouse (D-OR) on Senate floor, 171 CONGRESSIONAL RECORD at S2317 (April 4, 2025).

In light of that history, how did the Senate proceed with its use of the current policy baseline to extend indefinitely the tax cuts without a ruling from the Parliamentarian (and without having to overrule the Parliamentarian) about the Byrd rule? The Senate simply decided by majority vote that using the current policy baseline did not violate the Byrd rule, apparently without seeking advice (or approval) from the Parliamentarian.

Beginning immediately after the Senate budget resolution empowered Sen. Lindsay Graham, as Chair of the Senate Budget Committee, to determine the baseline for scoring the legislation, Republican senators said the Parliamentarian would not need to rule on use of the current policy baseline. Sen. Graham said on the Senate floor on June 30: "[W[e are not overruling the Parliamentarian because she said it was up to the Budget chairman to set the baseline." However, there is no indication that the Senate Parliamentarian ruled specifically that the current policy baseline approach was appropriate for purposes of applying the "no deficits beyond the budget window" provision in the Byrd rule. Indeed, Senate Republicans apparently specifically avoided posing the direct question to the Parliamentarian.

> Senate Democrats have tried multiple times to have a meeting with their GOP counterparts and the Senate parliamentarian to decide the crucial procedural question of whether extending President Trump's expiring 2017 tax cuts adds to future federal deficits.
>
> And Republicans so far have "flat out refused" to have any such discussion, they say.
>
> …
>
> Democrats say Republicans are trying to dodge Parliamentarian Elizabeth MacDonough from ruling on whether the tax portion of the "big, beautiful bill" exceeds the reconciliation package's deficit target for 2025 to 2034 and whether it increase deficits beyond 2034.
>
> Democrats think that if MacDonough weighs in on the subject, she would rule that Senate precedent requires that changes in tax law be scored on a "current law" baseline.
>
> Such a ruling would show extending the Trump tax cuts permanently violates the Senate's Byrd Rule.
>
> A person close to the conversation said that Senate Budget Committee Republicans "flat out refused" to meet with the parliamentarian to talk about what baseline should be used for Trump's big, beautiful bill.
>
> Democrats "asked that this be adjudicated by the parliamentarian," and Republicans "have refused, basically saying they can do what they want," said the source familiar with the behind-the-scenes debate.

…

> Republicans, however, say that the parliamentarian doesn't have a role in judging how much the tax portion of the One Big Beautiful Bill Act would add to the deficit within the bill's 10-year budget window or whether it would add to deficits beyond 2034.
>
> They argue that Budget Committee Chair Lindsey Graham (R-S.C.) has authority under Section 312 of the Congressional Budget Act "to determine baseline numbers of spending and revenue."
>
> …
>
> Taylor Reidy, a spokesperson for the Budget panel, asserted on the social platform X that "there is no need to have a parliamentarian meeting with respect to current policy baseline because Section 312 of the Congressional Budget Act gives Sen. Graham—as Chairman of the Budget Committee—the authority to set the baseline."

Alexander Bolton, *Senate GOP Declines to Meet With Parliamentarian on Whether Trump Tax Cuts Add to Deficit*, YAHOO!NEWS (June 29, 2025). *See also* Jordain Carney & Benjamin Guggenheim, *Republicans Move Forward With Controversial Megabill Accounting Move*, POLITICO (June 29, 2025) (Republicans "were able to sidestep a situation where senators would be asked to overrule Parliamentarian Elizabeth MacDonough on the baseline question. 'There is nothing to debate and we consider this matter settled…'").

The approval by majority vote in the Senate that using the current policy baseline did not violate the Byrd rule occurred on June 28 and June 30, 2025. Several points of order were considered on the Senate floor regarding the application of the current policy to the Byrd rule. The Senate by party-line votes of 53-47 upheld rulings by the Presiding Officer of the Senate that the current policy baseline did not violate provisions of the Byrd rule.

The summary of Senate Floor Proceedings for June 28 and June 30, 2025 (available at **www.senate.gov**) includes the following actions regarding Senate Amendment 2360 (which is the Senate substitute of the Act):

> [June 28]
>
> S. Amdt. 2360 (Sen. Graham): In the nature of a substitute.
>
> – Amendment SA 2360 proposed by Senator Thune for Senator Graham.
>
> – Point of order that the amendment violates section 313(b)(1)(E) of the Congressional Budget Act raised in Senate with respect to amendment SA 2360.
>
> – Ruling of the Chair that the point of order raised by Senator Thune with respect to amendment SA 2360, is that unless the Budget Committee, speaking through its chairman, asserts that the amendment causes a violation of the Budget Act, the Chair will not so hold.
>
> – Amendment SA 2360 ruled in order by the chair.
>
> – Motion by Senator Schumer to appeal the ruling of the Chair that amendment SA2360 is in order made in Senate.
>
> [June 30]
>
> – Considered by Senate.
>
> – Motion by Senator Schumer to appeal the ruling of the Chair that amendment SA 2360 does not violate section 313(b)(1)(E) of the CBA is in order, not agreed to by Yea-Nay Vote. 53 - 47.
>
> – Ruling of the Chair sustained.
>
> – Point of order that the amendment violates section 313(b)(1)(B) of the Congressional Budget Act raised in Senate with respect to amendment SA 2360.
>
> – Ruling of the Chair that the point of order raised by Senator Thune with respect to amendment SA 2360, is that unless the Budget Committee, speaking through its chairman, asserts that the amendment causes a violation of the Budget Act, the Chair will not so hold.
>
> – Amendment SA 2360 ruled in order by the chair.

> – Motion by Senator Merkley to appeal the ruling of the Chair that amendment SA 2360 does not violate section 313(b)(1)(B) of the CBA is in order made in Senate.
>
> – Motion by Senator Merkley to appeal the ruling of the Chair that amendment SA 2360 does not violate section 313(b)(1)(B) of the CBA is in order, not agreed to by Yea-Nay Vote. 53 - 47.
>
> – Ruling of the Chair sustained.

Section 313(b)(1) of the Congressional Budget Act lists "extraneous provisions" for purposes of the Byrd Rule.

> Section 313(b)(1)(B): any provision producing an increase in outlays or decrease in revenues shall be considered extraneous if the net effect of provisions reported by the Committee reporting the title containing the provision is that the Committee fails to achieve its reconciliation instructions
>
> Section 313(b)(1)(E): a provision shall be considered to be extraneous if it increases, or would increase, net outlays, or if it decreases, or would decrease, revenues during a fiscal year after the fiscal years covered by such reconciliation bill or reconciliation resolution, and such increases or decreases are greater than outlay reductions or revenue increases resulting from other provisions in such title in such year

The reason for the vote regarding section 313(b)(1)(B), that the Act does not fail to meet reconciliation instructions in the budget resolution, may be because the deficits produced under the Act using a current law baseline, as provided in the instructions to House committees, far exceed the deficit limits allowed under instructions to House committees. The House-passed version would have added $2.4 trillion to deficits over the budget window, and the Act adds $3.39 trillion to primary deficits according to the CBO. *Estimated Budgetary Effects of Public-Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline As Enacted on July 4, 2025*, CONGRESSIONAL BUDGET OFFICE (July 21, 2025).

h. **Emasculation of Byrd Rule?** Some commentators view the determination by majority vote in the Senate that the current policy baseline applies even to the limitation on producing deficits beyond the budget window effectively emasculates the Byrd rule regarding that restriction. A tax cut could be enacted for a very short period of time, and it could then be extended indefinitely in a future reconciliation act with a mere majority vote in the Senate. Another example: the Senate might approve universal health care for one year (by majority vote) and extend it permanently in the following year.

> Adopting a current policy baseline in reconciliation would be a dangerous and reckless move, especially given our near-record debt, exploding interest costs, and out-of-control borrowing trajectory. Our deficit is projected to total almost $2 trillion this year, and we're on course to borrow $22 trillion over the decade before any tax extensions. Any new legislation enacted by Congress should improve that trajectory, not make it worse.
>
> While employing a current policy baseline may be tempting to justify the current tax extensions, it would set a dangerous precedent for future actions. For example, if the temporary measures of the American Rescue Plan had been characterized as current policy, lawmakers could have extended them and added trillions of dollars to the debt with a $0 score.

Current Policy Baseline Would Set Dangerous Precedent, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Jan. 27, 2025) (statement from Maya MacGuineas, president of the Committee for a Responsible Federal Budget). See also Linda Qiu, *Trump and Republicans Mislead on Policy Bill's Effect*, NEW YORK TIMES (July 1, 2025) ("Congress could create a temporary universal health care or 'Medicare for all' program with a single-year cost of $3 trillion and, in the next year, claim that making the program permanent would cost nothing under a 'current policy' estimate.")

i. **Cuts to Medicaid and Affordable Care Act.** While wanting to cut spending, some members of Congress have been concerned with cuts to Medicare and the healthcare industry. For example, Sen. Josh Hawley (R-MO) expressed strong opposition to large Medicaid cuts. He pointed out that "21 percent of Missourians benefit from Medicaid or CHIP, the companion insurance program for lower-income children…. They're not on Medicaid because they want to be. They're on Medicaid because they cannot afford health insurance in the private market." He pointed out that many Missouri hospitals and health providers depend on the funding from those programs. *See* Catie Edmondson & Minho Kim, *Fiscal Hawks in Senate Balk at House's Bill to Deliver Trump's Agenda*, NEW YORK TIMES

(May 25, 2025). (Sen. Hawley voted for the Act, but he has subsequently filed the "Protect Medicaid and Rural Hospitals Act" that would reverse two major Medicaid cuts in the Act (limitations on the use of provider taxes and limitations related to state directed payments) and would double the fund to provide support for rural health facilities from $50 billion to $100 billion.) Those cuts were vigorously negotiated in the House and Senate between budget hawks who wanted deeper cuts and moderates who wanted fewer cuts.

The Congressional Budget Office, in a preliminary estimate, projects that the Act would reduce federal spending for Medicaid and the Affordable Care Act by more than $1 trillion over ten years and would increase by 11.8 million the number of people without health insurance by 2034. In addition, the expiration of tax credits that subsidize the premiums for health insurance through the Obamacare marketplaces, set to expire at the end of 2025 if they are not extended, would result in an additional 4 million being uninsured. An additional one million people are expected to lose insurance coverage as a recent of recent regulations making it harder to sign up for coverage through the Affordable Care Act. In total, these changes could lead to an additional 17 million people being uninsured. *See* Larry Levitt, *We've Never Seen Health Care Cuts This Big*, NEW YORK TIMES (July 1, 2025).

The Medicaid changes would require beneficiaries to pay more fees and complete more paperwork to use their coverage. The CBO estimates that the paperwork change would cause 2.3 million people to lose Medicaid coverage. States could require work or exemption reports as often as monthly, and many would likely fail to navigate this process. The bill updates the rules regarding "provider taxes," which are assessments levied on entities like hospitals and nursing homes that help states qualify for greater federal matching payments (this would save more than $30 billion over five years). Also, Medicare beneficiaries who earn more than the federal poverty limit (about $15,650 for a single person) would have to pay a $35 co-payment for doctor visits. Also, the proposed legislation would add a work requirement for poor, childless adults (requiring that they work 80 hours every month to stay enrolled in Medicaid). Changes to the Affordable Care Act would make numerous changes to enrollment processes for people who purchase their own insurance coverage in Obamacare marketplaces. *See* Margot Sanger-Katz and Catie Edmondson, *Republicans Propose Paring Medicaid Coverage but Steer Clear of Deeper Cuts,* NEW YORK TIMES (May 12, 2025).

The cuts in Medicaid funding may cause substantial funding concerns for rural hospitals and health care and for nursing home facilities. Medicaid covers one-fifth of hospitalizations and nearly half of all births in rural areas. The Act includes a $50 billion temporary rural health stabilization fund, but that won't fully blunt the cuts, which are permanent. *See* Larry Levitt, *We've Never Seen Health Care Cuts This Big*, NEW YORK TIMES (July 1, 2025).

j. **Nutrition Program Cuts.** The Act reduces spending for the Supplemental Nutrition and Assistance Program (SNAP), commonly referred to as food stamps, and other nutrition assistance programs, by $267 billion over ten years. It expands work requirements for parents with children over age 7, and increases the work requirements age to 64. It shifts 5% of benefit costs and 75% of administrative costs to states beginning in 2028, costs that most states cannot absorb easily.

k. **SALT Deduction Cap Compromise.** Relaxing the $10,000 cap on deductions for state and local taxes was a very hotly negotiated issue in the House. A handful of representatives from high-tax states vowed not to vote for the bill unless significant changes were made. Five House Republicans said they would vote against a bill with only a $30,000 cap. Eventually, the House negotiated to increase the cap to $40,000 with a phase-out for income between $500,000 and $600,000. That provision is costly, and various Senate Republicans (none of whom were from high-tax states) were upset with deficits produced by the House bill and wanted to revert to the $10,000 cap. Several House members again vowed to vote against the bill if the negotiated settlement was not retained. Ultimately a compromise was reached with those House members to keep the $40,000 cap but extend it for only five years (2025-2029).

l. **Political Realities.** Despite significant concerns by various Representatives and Senators, House Speaker Mike Johnson and Senate Majority Leader John Thune, with substantial influence from President Trump, were highly successful in whipping votes to secure passage of the Act.

Sen. John Kennedy (R-LA) colorfully predicted back in April that President Trump's arm-twisting would be needed to secure final approval of the Act.

> It'll be a lively 60 days. It will be a job for alcohol, not coffee. But at the end of 60 days, there will not be a consensus. We're going to have to go to the White House, and the president's going to have to be the arbiter, and then he's going to have to put his muscle behind it. That's the way that it will ultimately pass.

Katie Lobosco & Doug Sword, *Ways and Means Markup of Tax Bill Likely Week of May 5*, BLOOMBERG DAILY TAX REPORT (April 30, 2025).

President Trump was very direct in threatening to "primary" Republicans who voted against the Act. He said "Close your eyes and get there. It's a phenomenal bill. Stop Grandstanding. Just stop grandstanding." He posted on his Truth Social platform: "MAGA is not happy, and it's costing you votes."

m. **Investors' Influence May Ultimately Force Congress to Address Deficits.** On May 16, 2025, Moody's lowered its credit score on the U.S. government, citing the country's long streak of large budget deficits and "current fiscal proposals under consideration." The downgrade by Moody's means that all three major rating agencies no longer consider the U.S. qualified for their top credit ratings. Rep. Andy Harris (R-MD), who later voted "present" in the House vote on the bill, responded to the credit downgrade: "Moody's downgrade of America's debt is a signal that we can wait no longer to address the debt crisis," adding that he was not supporting the tax package without substantial changes. *See* Tony Duehren & Joe Rennison, *U.S. Downgraded by Moody's as Trump Pushes Costly Tax Cuts*, NEW YORK TIMES (May 16, 2025).

On May 21, 2055, the 30-year Treasury yield rose to 5.14%, its highest level since October 2023, and the 10-year Treasury rose to 4.61%, a large move reflecting investors' worries over the deficit. *See* Colby Smith & Joe Rennison, *Why Washington's Huge Tax Bill Is Worrying Bond Investors*, NEW YORK TIMES (May 21, 2025). (Those rates have since returned to lower levels.) Also troubling is that while higher rates tend to push up the value of the U.S. dollar, the currency has slid in value against the euro, yen, and others, raising questions about the "safe haven" status of U.S. assets by foreign investors.

> The most troubling part of the market reaction is that the dollar is weakening at the same time. To us this is a clear signal of a foreign buyer's strike on US assets and the associated US fiscal risks we have been warning for some time. At the core of the problem is that foreign investors are simply no longer willing to finance US twin deficits at current level of prices.

David Goldman, *Why the Bond Market Is So Worried About the 'Big, Beautiful Bill,'* at CNN.com (May 22, 2025) (quoting George Saravelos, head of FX research at Deutsche Bank). A crisis in which the U.S. government can no longer finance its debt is "likely to happen" in coming years "if the budget deficit is not cut a lot." Ye Xie, *The Bond Investors Threatening Trump's Tax Bill: Quick Take*, BLOOMBERG DAILY TAX REPORT (May 20, 2025) (quoting Ray Dalio, billionaire founder of Bridgewater Associates hedge fund). The slide of the U.S. dollar has continued throughout 2025; the U.S. dollar index, which measures the currency's strength against a basket of six others, including the pound, euro, and yen, fell 10.8% in the first half of 2025, to its lowest level since February 2022. *See* Alex Kozul-Wright, *Why Is the US Dollar Falling by Record Levels in 2025?*, ALJAZEERA (July 1, 2025).

Jamie Dimon, JPMorgan Chase CEO, warns that the U.S. government's rising debt and budget deficits are a problem that eventually will cause bond market issues. "It's a big deal, you know it is a real problem, but one day … the bond markets are gonna have a tough time. I don't know if it's six months or six years." *See* Eric Revell, *Jamie Dimon Warns US Debt and Deficits Are a Growing Problem*, FOX BUSINESS (June 2, 2025).

Investor actions can influence policy decisions. When the bond market reacted badly to President Trump's extreme tariffs proposal, the administration backed off the proposal on April 9, 2025, but financial markets remained worried about a "bond-market death spiral" possibility in which high debts drive up borrowing costs, which slows the economy, which in turn makes it more difficult for the government to pay back debt, leading to an economic crisis. "Bond vigilantes" have forced policy changes in the past.

- President Bill Clinton was forced to scale back his ambitious domestic agenda (including a middle class tax cut) in the 1990s (Pres. Clinton raged to aides: "You mean to tell me that the success of the economic program and my re-election hinges on the Federal Reserve and a bunch of [expletive deleted] bond traders?")
- Sweden in the 1990s was forced to slash spending when an important investor in a Stockholm-based insurer pledged not to buy "a single Swedish" bond unless the government cut the deficit.
- Massive stimulus payments by governments around the world following the Covid-19 pandemic caused central banks to raise interest rates aggressively, leading to a record 17% loss in returns on government bonds globally in 2022.
- In 2022, the UK abandoned its plan for the biggest tax cuts since 1972 when investors dumped the country's bonds, and the market rout forced Prime Minister Liz Truss to resign, 44 days into her term.

See id.

6. Estate Tax Repeal?

An effort to repeal the estate tax does not seem likely in the foreseeable future – even though Sen. John Thune (R-SD), the Senate majority leader, has repeatedly introduced estate tax repeal bills and initially won his Senate seat in part by running against the "death tax." If Republican leadership had wanted to repeal the estate tax, a repeal measure could have been included in the Act, but it was never seriously considered for inclusion in the Act. Project 2025 does not call for the repeal of the estate tax but to reduce the estate tax rate to 20%. Repealing the estate tax would feed into Democrats' arguments that massive Medicaid and nutrition program cuts and other cuts to the social safety net programs are being made to provide tax breaks for wealthy Americans.

Some suggest that the continued existence of the estate tax has political advantages and that its existence provides "reputational shelter" for wealthy families.

> Politicians on both sides of the aisle benefit from its symbolic survival. For conservatives, the estate tax remains a reliable talking point about government overreach and family farms. For progressives, it stands as a nominal bulwark against plutocracy (and its cousin, the "broligarchy"). Meanwhile, the wealthiest families (and their advisers) enjoy both reputational shelter and practical immunity. As Madoff said, "So long as the estate tax stands, even in its current moribund form, the wealthy can point to it to make the public believe that they are paying their fair share" [citing Ray D. Madoff, *A Signature GOP Issue Is Omitted From Trump's 'Big' Tax Bill. Weird*, WASHINGTON POST (June 30, 2025)].
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> …
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> Very wealthy families now enjoy a reputational shelter of sorts; they can point to a nominal estate tax that rarely applies but enjoy practical immunity, thanks to stepped-up basis, untaxed capital gains, and sophisticated trust planning.
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> The estate tax may still be on the books, but its regulatory force has essentially been rendered ineffective. Its death, however, is not an end, but a pivot. The OBBBA ushered in a post-estate-tax landscape characterized not by the tax's repeal but its irrelevance. Generous exemptions are now in place, but loopholes remain. Ultrawealthy families face little to no meaningful constraints on their ability to pass down vast wealth free of taxation. A tax system once intended to redistribute wealth now functions chiefly as rhetorical camouflage for it.

Bridget Crawford & Maggie Meinhardt, *The Estate Tax Lives On, but Only in Name*, 188 TAX NOTES FEDERAL 921 (Aug. 11, 2025).

For a discussion of estate tax repeal bills filed in the House and Senate in 2025, see Item 3.b.(22) of LOOKING AHEAD – Estate Planning in 2025 & Current Developments (Including Observations from Heckerling 2025) (June 30, 2025) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. But the active pursuit of estate tax repeal legislation does not appear on the horizon.

7. Impact of Estate and Gift Tax Measures in the Act on Planning

a. **Reduced Perceived Pressure to Make Gifts.** The permanent extension of the increased $15 million exclusion amount has reduced the perceived pressure on clients to take advantage of the large exclusion amount before it may be slashed in half. With indexing for inflation, the exclusion could easily be over $20-$30 million in 10 years. That could be changed by a future Congress, but likely only if Democrats were to have control of the administration, the Senate, and the House, and clients would have plenty of lead time for planning before the exclusion might be decreased. Furthermore, a reduction of the estate and gift tax exclusion amount would likely require a significantly larger than mere majority in the Senate and House, because the estate tax is a hot political issue and some Democratic Congresspersons will be opposed to reducing the exclusion amount. Clients who were not totally comfortable making large gifts are probably the clients most interested in implementing transfer planning with SLATs, so we may see less emphasis on SLATs going forward.

b. **Transfer Planning.** Clients who have enough wealth that they are comfortable making gifts are best advised to make the gifts currently, so that future appreciation can be removed from the estate. There seems to be more stability in the estate tax system than perhaps in decades. There has been little (or no) discussion of estate tax repeal. This may be a good time for reporting gift and sales transactions to commence a 3-year period of limitations, particularly in light of ongoing cutbacks to IRS funding. (Appraisers report that they are becoming busy with 2025 year-end transfer planning transactions.)

   While the large exclusion amount means that many clients will not have federal transfer tax concerns, many states have estate taxes with exemptions much lower than the federal exemption, and transfer planning can still be important for saving state estate taxes.

c. **Non-Grantor Trusts**. While grantor trusts offer very significant advantages for transfer tax planning purposes, planning with non-grantor trusts may become more significant for various purposes (even for individuals who may have estate tax concerns), including income shifting, taking advantage of increased SALT deduction caps, "stacking" QSBS shares to take advantage of the increased $15 million cap, allowing additional §199A deductions for qualified business income, and saving state income taxes. Structuring a trust to be a non-grantor trust is not necessarily easy; see the discussion below about structuring non-grantor trusts.

d. **Basis Adjustment Planning.** Relatively speaking, almost no decedents will pay federal estate taxes, but all estates enjoy a basis adjustment under §1014 at an individual's death. Planning to take advantage of the basis adjustment at death under §1014 will be especially important for those clients who will pay no federal estate tax.

e. **Changed Paradigm**. The increased "permanent" $15 million exclusion amount means that estate and gift taxes are irrelevant for most clients. Concepts that have been central to the thought processes of estate planning professionals for their entire careers are no longer relevant for most clients – even for "moderately wealthy" clients (with assets of $10 million dollars, or even more). For example, structuring trusts to qualify for the gift tax annual exclusion may be unnecessary for many clients who will *never* have any gift or estate tax concerns (though professional advisers must still advise them of the requirement to file gift tax returns reporting any taxable gifts that do not qualify for the annual exclusion). Structuring testamentary charitable trusts to qualify for the estate tax charitable deduction under §2055 will no longer be important for many clients. It is hard for "old dogs to learn new tricks," and planners will constantly have to be sensitive to the major paradigm shift resulting from the Act.

   Using credit shelter trusts can be tax disadvantageous for clients who will pay no estate tax (by losing the basis adjustment at the surviving spouse's death). Clients should have their estate plans revised in light of the important estate tax changes made in the Act. Clients who do not have transfer tax concerns may want to remove formula bequests to credit shelter trusts. Portability planning may become more important to maximize basis adjustment planning flexibility. Planners may be faced with an increasing number of situations involving clients with existing irrevocable trusts that no longer provide transfer tax benefits and that may be disadvantageous for basis adjustment purposes.

8. Planning With Non-Grantor Trusts

a. **Income Tax Advantages of Non-Grantor Trusts.** Contributing to and accumulating assets in non-grantor trusts may have various income tax advantages.

(1) **Income Shifting**. Income of a non-grantor trust is not taxed entirely to the grantor, as with grantor trusts. Undistributed income is taxed to the trust at highly compressed tax brackets (the top 37% bracket is reached at only $15,650 in 2025. However, distributions that "carry out" distributable net income (DNI) will be deductible to the trust and includable in the income of the recipient-beneficiary, thus shifting taxable income to the beneficiary. Capital gain income is typically not included in DNI, so to maximize income shifting, consider ways to cause capital gain to be included in DNI, but the income shifting tax advantage is not as steep, because the maximum rate bracket is only 20% vs. 37% for ordinary income. For a discussion of ways to cause capital gains to be included in DNI, see Item 5 of Akers, ACTEC 2016 Summer Meeting Musings (Including Fiduciary Income Tax "Bootcamp") (Sept. 26, 2016) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

As a simple example of the income shifting advantage, in 2026 the 22% bracket for joint returns is from $100,800 to $211,400 and the 37% bracket for joint returns begins at $768,700. Shifting $100,000 of income from the 37% to the 22% bracket would save $12,000. Income shifting will probably require distribution to low-bracket beneficiaries. If the income is left in and is taxable to the trust, in 2026 the trust reaches a 24% bracket at only $3,3000 of taxable income, 35% at taxable income of $11,700, and 37% at taxable income of $16,000.

Make sure that the distribution standards for the non-grantor trust are consistent with shifting income (if that is a relevant goal). The trustee will have to exercise its fiduciary duty to make distributions in accordance with distribution standards, in and purposes of, the trust, not just based on whether the distributions reduce income taxes.

(2) **Taking Advantage of Increased SALT Deduction Caps.** The increase in the SALT deduction from $10,000 to $40,000 in 2025-2029 phases out for income in excess of $500,000. Shifting income may result in multiple taxpayers being able to take advantage of the full $40,000 SALT deduction.

(3) **"Stacking" QSBS Shares to Take Advantage of the Increased $15 Million Cap.** The special gain exclusion for the sale of qualified small business stock (QSBS) was enhanced by the Act in three ways beginning in 2026: (1) gain exclusion up to 100% exclusion is based on holding the stock for at least 3 to 5 years; (2) the per-issuer exclusion cap in any year is increased from $10 million to $15 million (indexed for inflation); and (3) the corporate-level gross asset threshold is increased from $50 million to $75 million. See Item 4.o above. Dividing the ownership of QSBS stock among multiple taxpayers (including non-grantor trusts) could increase the number of $15 million exclusions when the stock is sold.

(4) **Allowing Additional §199A 20% Deductions for Qualified Business Income.** Trusts can make use of the §199A 20% deduction for qualified business income of noncorporate entities. The 20% deduction phases out for qualified business income from a pass-through entity that is a "specified trade or business" if the taxpayer has taxable income over a certain threshold (in 2025, the phase-out begins at $394,600 and the phase-out is complete at $494,600). Having interests in the entity owned by multiple taxpayers (including non-grantor trusts) can allow each such taxpayer to take advantage of the full 20% deduction if the taxpayer has income below the threshold level.

(5) **Charitable Deduction.** Splitting income among multiple taxpayers using non-grantor trusts can reduce the grantor's income for purposes of applying the 0.5% cutback of the grantor's charitable deduction (and trusts are not subject to the 0.5% charitable deduction cutback). However, that is not a particularly significant factor in most situations.

(6) **Saving State Income Taxes.** State income taxes may be avoided if "non-sourced" taxable income of a non-grantor trust is not subject to a state's income tax (often by avoiding having a resident trustee or local trust administration in that state).

(7) **Avoid Multiple Trust Rule.** The federal income tax advantages may not be available if the trust violates the multiple trust rule of §643(f), which states that multiple trusts will be treated as one trust for federal income tax purposes if (1) the trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of federal taxes. If that provision applies, splitting income among multiple trusts would not be respected for federal income tax purposes.

Regulations finalized following the enactment of §199A issued in 2018 adopted (1) an anti-abuse rule for trusts regarding §199A and (2) a separate general multiple trust rule under a regulation to §643. The §199A anti-abuse regulation changed a provision in the proposed regulation referring to a "significant purpose" test to whether the trust is formed or funded with a "principal purpose of avoiding, or of using more than one, threshold amount." Reg. §1.199A-6(d)(3)(vii). Accordingly, that rule could apply to a single trust, and the effect is that the trust is not respected "as a separate trust entity for purposes of determining the threshold amount."

The §643 proposed regulation addressed the principal purpose requirement by stating that "[a] principal purpose for establishing or funding a trust will be presumed if it results in a significant income tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation of these separate trusts." Prop. Reg. §1.643(f)-1(b). The proposed regulation also had two examples illustrating this "significant income tax benefit" test. That approach was strongly criticized as being inconsistent with the statutory provision, and the final regulation omitted those provisions about the primary purpose requirement and just includes a general rule that restates the statute. Reg. §1.643(f)-1.

The IRS's approach to §199A might also be applied to the other threshold matters (QSBS stacking, SALT deduction, etc.). In any event, the statutory language of §643(f) only applies to trusts with substantially the same grantor or grantors and "substantially the same beneficiary or beneficiaries." Accordingly, where non-grantor trusts are employed to achieve some of the federal tax advantages described above, consider using trusts with different primary beneficiaries. *See* Jonathan Blattmachr & Martin Shenkman, *Flexible Beneficiary Trusts: Reducing Income Tax on Non-Grantor Trusts*, 47 ACTEC L.J. 301 (Spring/Summer 2022) ("creating one trust primarily for each child (or possibly each descendant) of a taxpayer likely will not fall under the consolidation of trusts rules of Section 643(f)").

b. **General Structuring Approaches – Incomplete Gift Trust or Completed Gift Trust.** The non-grantor trust could be structured either as an incomplete non-grantor trust (sometimes referred to as an "ING" trust) or as a completed gift trust. *See generally* Bob Keebler & Steve Oshins, *Tax Trifecta after the One Big Beautiful Bill Act*, LEIMBERG INCOME TAX PLANNING NEWSLETTER #271 (July 23, 2025).

"ING trusts" have been used historically for state income tax savings, but they could also be used for the other advantages described above. Because the gift to the trust is incomplete, there is no 40% gift tax on the creation of the trust. A distribution committee may make distributions to beneficiaries, including the grantor. (The trust must be created in a state with a "DAPT statute" that does not permit the grantor's beneficiaries to reach the trust assets merely because the grantor is a potential beneficiary.) ING trusts are complicated, and IRS private letter rulings have provided guidance on how they should be structured (and that guidance has changed over the years). See Item 37 of Akers, Estate Planning: Current Developments and Hot Topics (Dec. 2013) (discussing Letter Rulings 201310002-201310006) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. The feature that causes the gift to the trust to be incomplete for federal gift tax purposes would also cause the trust assets to be included in the grantor's gross estate at the grantor's death, so these trusts are not used for estate tax savings purposes. Clients who have estates well under the $15 million (indexed) "permanent" estate tax exclusion amount may prefer this structure so that assets in the trust will be entitled to a basis adjustment under §1014 at the grantor's death.

Completed gift trusts involve current gifts subject to the federal gift tax but are much simpler. Assets in the trust at the grantor's death are not subject to estate tax (if the trust is structured properly). Special features could be added to allow a basis adjustment at the grantor's death to the extent that estate tax would not be generated at that time. See Item 9 below.

c. **Structuring Checklist.** Structuring a trust to be a non-grantor trust is not necessarily easy to do. Indeed, careful structuring of the trust agreement is not enough; trust administration should be monitored to assure that no actions are taken that would convert the trust (or a portion of the trust) to a grantor trust (such as paying a premium of life insurance on the grantor's life). The following is a brief summary of planning considerations for structuring a non-grantor trust.

(1) **Section 672(e) – Powers or Interests Held by Grantor's Spouse.** In applying all of the grantor trust rules, bear in mind that the grantor is treated as holding any power or interest held by (A) any individual who was the grantor's spouse at the time of the creation of such power or interest, or (B) any individual who became the grantor's spouse after the creation of such power or interest but only as to periods after becoming the spouse. §672(e). The checklist below sometimes just refers to prohibitions on certain powers or interests of the grantor (if that is what the statute says), but observe in all those circumstances, such power or interest held by the grantor's spouse will be treated as being held by the grantor.

Section 672(e) literally applies even after the spouse is divorced from the grantor if that individual continues to hold an interest or power in the trust, although the IRS has been requested (for example, by ACTEC following the repeal of §682) to interpret §672(e) in a narrower manner. Some planners have suggested that there is no longer a concern about the "continuing grantor trust after divorce" issue under §672(e) because of a recent case, *Scenic Trust v. Commissioner*, T.C. Memo. 2024-85 (2024). An issue in that case was whether the "Scenic Trust" was a grantor trust in 2013. The trust stated that beneficiaries were "my heirs at law." The settlor was not married when the trust was created, but his wife became a beneficiary upon being married to the settlor, so the trust would be a grantor trust under §677 when she was a beneficiary. The settlor argued that they were legally separated in 2013 and pointed to a marital separation agreement, but the court said there was no evidence of a decree of divorce or filing of a marital separation agreement. "Therefore, we treat Mrs. Simpson as Mr. Simpson's spouse for purposes of section 677 for 2013." That reasoning and conclusion is not relevant to the §672(e) issue, which is that if the spouse continued to be a beneficiary after the divorce, that interest would be attributed to the settlor, so §677 would apply. In *Scenic Trust*, the divorced spouse ceased to be a beneficiary following a divorce, so there was no issue of attributing the individual's interest to the settlor even after the divorce under §672(e).

An excellent article by Austin Bramwell and Leah Socash (New York, New York) makes a persuasive argument that applying the spousal unity rule of §672(e) to ex-spouses "is unconstitutional under the due process clause limitations announced in *Moore* and that the grantors have a constitutional right not to be taxed on their ex-spouses' trust income." Austin Bramwell & Leah Socash, *The Spousal Unity Rule: An Unconstitutional Trigger of Grantor Trust Tax*, 188 TAX NOTES FEDERAL 1955 (Sept. 22, 2025) (hereinafter Bramwell & Socash). Their arguments include the following.

- *Moore v. United States*, 602 U.S. 572 (2024,) addressed Fifth Amendment due process limitations on attributing income, holding that income realized by foreign entities could be attributed to domestic shareholders but stating that "arbitrary" attributions of income would be proscribed. (The petition for *certiorari* presented the issue of whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states. The Court changed the subject from the taxation of unrealized sums to whether income that has been realized by one person or entity can be attributed to other taxpayers.)
- The majority opinion did not elaborate on exactly what attributions would be treated as arbitrary but suggested three sources of guidance: (1) Congress may attribute income of a business entity to its owners, at least when the entity has not been taxed on the same income; (2) *Burnet v. Wells*, 289 U.S. 670 (1933), provides guidance on the extent to which

income realized by an irrevocable trust could be attributed back to the grantor; and (3) the Court gave great weight to the long settled and established practice of attributing corporate income to its shareholders and the Court was reluctant to trigger a "fiscal calamity" by rendering large swaths of the Code unconstitutional. Factors (1) and (3) have no bearing on attributing trust income for ex-spouses to the grantor; business entities or corporations are not involved and no "fiscal calamity" would arise from striking down the spousal unity rule as to ex-spouses. That leaves the *Wells* factor.

- *Wells* addressed the constitutionality of taxing a grantor on trust income used to pay premiums of life insurance on the grantor's life. The Court made clear the judiciary would rarely question Congress's judgment regarding the attribution of income, but made clear that it does draw a line. Courts should consider both the "relation between the parties" and the "tendency of the transfer to give relief" from moral obligations, that is, obligations "recognized as binding by normal men and women" – in effect, relying on a commonsense sociology about what "normal men and women" consider to be obligatory.
- This analysis from *Wells* cuts against being able to attribute trust income for ex-spouses to the grantor.

> But a commonsense sociology like the one that justified attribution in *Wells* leads to a very different result in the case of a trust held for the benefit of an ex-spouse after divorce. Few would assert that one spouse, if not legally bound to do so (under a marital or property settlement agreement, for example), has a moral obligation to provide a fund for the other that continues after divorce. To the contrary, divorce is an adversarial process that is time-consuming, expensive, and frequently acrimonious. The default moral framework that normal men and women apply to divorce, if anything, is that spouses are entitled to get as much as and give as little to the other as possible.
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> Thus, the *Wells* test, forgiving as it is, cannot save the spousal unity rule. Commonsense sociology suggests that a grantor is positively harmed, in the eyes of "normal men and women," by the postdivorce continuation of income tax on an irrevocable trust for an ex-spouse. The relationship between ex-spouses is literally adversarial, yet a SLAT ends up benefiting one party while the other gets nothing in return. In the words of *Wells*, section 672(e) manages to find equivalence to ownership where none exists.

Bramwell & Socash, *supra* at 1960-61.

- In oral argument, the government suggested three factors of arbitrariness, which Justice Barrett recited in her concurrence, bolstered with citations provided by her: (1) the degree of the taxpayer's power and control over the income; (2) whether the taxpayer receives a special privilege or benefit from the entity that earns the income; and (3) whether the income accumulates in an entity offshore. Applying those factors to the spousal unity rule for ex-spouses: (1) the grantor may have no power and control over the income, and the power *ab initio* to declare the terms of the trust is not sufficient (or else this factor would always be present and a retained benefit analysis would be unnecessary); (2) "a divorced grantor does not benefit from having property held in trust for an ex-spouse outside of what is required as part of a divorce settlement"; instead, "[t]he divorced grantor is, if anything, harmed by having put assets out or reach of the marital estate.", *id*. at 1965; and (3) the offshore accumulation of income factor is irrelevant.
- *Hoeper v. Tax Commission of Wisconsin*, 284 U.S. 206 (1931) addressed a Wisconsin statute that taxed each spouse on the combined income of the married couple. The Court held that was unconstitutional under the Fourteenth Amendment's due process clause: "That which is not in fact the taxpayer's income cannot be made such by calling it income." 284 U.S. at 215. The Bramwell-Socash article summarizes:

> If, under *Hoeper*, it is unconstitutional to tax one spouse on the other spouse's income, then *a fortiori* it is unconstitutional to tax one former spouse on another former spouse's income. To treat a married

> couple as a single economic unit, as Holmes would have done in *Hoeper*, is one thing. It is quite another to treat ex-spouses the same way when the very purpose of divorce is separation. Both the *Hoeper* majority and *Hoeper*'s dissenters and later critics must agree that a statute attributing income from one former spouse to another violates due process protections.

Bramwell & Socash, *supra* at 1965.

(2) **Adverse Party – §672(a), Reg. §1.672(a)-1.** A number of the grantor trust rules depend on whether the consent of an adverse party to a particular action is required. "[T]he term 'adverse party' means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust." §672(a). "An interest is a substantial interest if its value in relation to the total value of the property subject to the power is not insignificant." Reg. §1.672(a)-1(a). "Ordinarily, a beneficiary will be an adverse party," but the regulations provide various qualifiers to that general statement. Reg. §1.672(a)-1(b)-(d). Whether a person is adverse in any particular situation is necessarily a "facts and circumstances" matter, and some authorities suggest that the nature of family relationships in a particular situation may be considered. Accordingly, whether an adverse party's consent in a given situation is required may be subject to some degree of uncertainty.

A recent case discussed the adverse party issue. *Scenic Trust v. Commissioner*, T.C. Memo. 2024-85 (2024). The trustee was not a beneficiary of the trust, but the trust settlor argued that he had a beneficial interest "because he engaged in fraud to enrich himself with Scenic Trust assets." The court concluded that the evidence did not support that claim. "[The trustee] did not take any action without the explicit or implicit approval [of the settlor, and] every decision was made for the benefit of [the settlor]. Therefore, [the trustee] would not be adversely affected by the exercise or nonexercised of his powers as trustee…"

(3) **Section 674 Issues – Power to Control Beneficial Enjoyment.**

(a) **General Rule, §674(a).** The general rule under §674(a) is that a trust is a grantor trust if anyone, including the grantor or grantor's spouse, has a power of disposition affecting beneficial enjoyment of the income or corpus without the consent of an adverse party. This general rule could be avoided by requiring the consent of an adverse party. Otherwise, one of the exceptions in §674(b)-§674(d) described in subparagraphs (b)-(d) immediately below must be used to avoid grantor trust treatment.

(b) **Independent Trustee, §674(c).** Use an independent trustee (someone other than the grantor or grantor's spouse and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor) and give them the authority to distribute assets among a designated class of beneficiaries, §674(c).

A "related" party is a nonadverse party who is the grantor's father, mother, issue, brother, or sister. ("Unrelated" parties would include an aunt, uncle, niece or nephew, cousin, grandparent, or any of their spouses.) "Subordinate parties" are employees of the grantor or of a corporation in which the combined voting power of the grantor and trust is "significant" or in which the grantor is an executive. Subservience to the wishes of the grantor is presumed unless shown otherwise by a preponderance of the evidence. §672(c).

(c) **Trustee Other Than Grantor or Grantor's Spouse With Reasonably Definite Standard, §674(d).** Use a trustee other than the grantor or grantor's spouse, whose distribution powers over income, including accumulated income, are limited by a reasonably definite external standard, § 674(d). (Avoid providing that the trustee's discretion shall be "final and conclusive" or similar words. That might endanger whether the "reasonably definite external standard" is satisfied.)

(d) **No Limit on Who is Trustee.** With no limitation on who is the trustee (including having the grantor or grantor's spouse as a trustee) meet the §§674(b)(5) & 674(b)(6) exceptions.

i. **Corpus, §674(b)(5).** As to **corpus** use a reasonably definite distribution standard (or have separate shares for the beneficiaries), §674(b)(5).

ii. **Income, §674(b)(6).** As to **income**, do not allow any sprinkling powers [that is key] and either—

a. use a trust for a single beneficiary that ultimately must be paid to that beneficiary, her estate or to her appointees under a very broad limited power of appointment that does not exclude anyone other than her, her creditors, her estate, or the creditors of her estate (but the settlor may be uncomfortable giving the beneficiary that broad of a power of appointment), or

b. provide that the income must ultimately pass to current income beneficiaries in irrevocably specified shares, and for this purpose if a beneficiary dies before a distribution date that the beneficiary could reasonably have been expected to survive, the deceased beneficiary's share could pass to her appointees or to designated alternate takers (other than the grantor or grantor's spouse) in irrevocably specified shares (satisfying this option requires that the trust terminate in favor of a beneficiary on a date that is reasonably expected to occur during the beneficiary's lifetime), §674(b)(6), or

c. during the legal disability of the beneficiary or while the beneficiary is under age 21, the trustee can have the discretion to distribute income or to accumulate income and add it to corpus, §674(b)(7).

(e) **Power to Add Beneficiaries.** No one other than an adverse party should have the power to add beneficiaries (that would be an exception to the §674(b)(5), §674(b)(6), §674(b)(7), §674(c), and §674(d) exceptions). For example, do not give a nonadverse party the authority to add the grantor (or grantor's spouse) as a potential discretionary beneficiary at a later time; this has been suggested as a planning alternative for "domestic asset protection trusts," to provide possible stronger asset protection (such person might never be added as a discretionary beneficiary if they never need any distributions from the trust), but do not give that authority to a nonadverse party if the trust is structured to be a non-grantor trust.

(f) **Inter Vivos Power of Appointment.** Even if one of those exceptions is satisfied, also make sure that no one who is not an adverse party holds an inter vivos power of appointment. Section 674(b)(3) has an exception for testamentary powers but not inter vivos powers.

(g) **Other Limited Application Exceptions.** Several other limited application exceptions apply regarding powers exercisable only after certain events, §674(b)(2), or powers to allocate among charitable beneficiaries, §674(b)(4).

(4) **Section 675 Issues – Administrative Powers.**

(a) **Power to Deal For Less Than Full Consideration, §675(1).** Prohibit anyone from dealing with trust assets for less than full and adequate consideration, §675(1).

(b) **Power to Loan to Grantor For Inadequate Interest or Security, §675(2).** There should be no power to make a loan to the grantor or grantor's spouse without adequate security or adequate interest (other than a general lending power to make loans to any person without regard to interest or security), §675(2).

(c) **Grantor Borrowing, §675(3).** The grantor or grantor's spouse should not actually borrow assets from the trust (or purchase assets from the trust for a note, *see* Rev. Rul. 85-13) at any time during the year, (but borrowing with adequate interest and adequate security will not cause grantor trust treatment if the loan is made by a trustee other than the grantor, grantor's spouse, or a related or subordinate trustee) §675(3).

(d) **Non-Fiduciary Powers, §675(4).** No one (even an adverse party) should have a power, exercisable in a non-fiduciary capacity:

-to vote or direct the voting of securities of a corporation in which the holdings of the grantor (or grantor's spouse) and the trust are significant (and there is no definition of "significant") from the viewpoint of voting control, §675(4)(A);

-to control the investment of trust assets to the extent the assets consist of securities of a corporation in which the holdings of the grantor (or grantor's spouse) and the trust are significant, §675(4)(B); or

-to substitute assets for equivalent value, §675(4)(C).

A power to vote or control investments in securities described in §675(4)(A)-(B) might arise, for example, with directed trusts (if the direction advisor acts in a non-fiduciary capacity) or possibly even if the manager of an LLC that owns such securities has the power to vote or control the investment of such assets.

(5) **Section 676 – Power to Revoke.** No one other than an adverse party may have a power to revest in the grantor title any portion of the trust. §676.

(6) **Section 677 Issues (Including Issues for a Non-grantor SLAT).**

(a) **Consent of Adverse Party, §677(a)(1).** If the grantor or grantor's spouse is a permissible beneficiary (i.e., income may be distributed or accumulated for his or her benefit), require the consent of an adverse party, §677(a)(1)-(2). (The adverse party's consent must be continued even after the grantor's death as to income, including capital gains, that are accumulated prior to the grantor's death, *see* Reg. §1.677(f).) Requiring the consent of an adverse party (which could be another current beneficiary or a first-level remainderman) raises (1) family dynamics issues and (2) potential gift tax issues if an adverse party consents to such a distribution that has the effect of diminishing the value of her own interest.

(b) **No Spouse Interest Until After Grantor's Death, §677(a)(1).** If an adverse party's consent is not required, the grantor's spouse should not become a permissible beneficiary until after the grantor's death, and then only as to future income (not income and capital gains accumulated before death; perhaps the accumulated income and capital gains would be segregated into a separate trust because otherwise, tracing the portion of the trust assets attributable to accumulated income could be quite cumbersome). Perhaps someone could be given the authority to add the grantor's spouse as a discretionary beneficiary after the grantor's death (but not including any accumulated income), but that would raise the potential uncertainty of whether that is a power to add beneficiaries, which would negate some of the §674(b)-(d) exceptions.

(c) **Life Insurance Premiums, §677(a)(3).** Prohibit the trust from paying any life insurance premiums on the grantor's life (if the trust is not expected to own such a policy for which future premium payments will be needed) or require the consent of an adverse party (*e.g.*, [i] someone who cannot benefit from the insurance death proceeds or [ii] someone who is a mandatory income beneficiary whose distributions are reduced directly as a result of consenting to the use of income to make premium payments) to make premium payments with trust assets. The statute suggests that merely prohibiting the trustee from using income to pay premiums would be sufficient, but Letter Ruling 8839008 held that a trust that prohibited the trustee from using trust income to pay premiums was still a grantor trust as to premiums actually paid because the payment from fiduciary accounting principal of the trust was deemed to come from taxable income. (The trust is likely a grantor trust only as to the amount of taxable income used to make premium payments, see Rev. Rul. 66-313.) That's the state of the law, and unfortunately it leaves a considerable amount of uncertainty as to whether a trust that owns life insurance on the grantor's life is a non-grantor trust.

What can we do in a planning mode for structuring new ILITs (for which it is impractical to prohibit the trust from paying insurance premiums) or for modifying existing ILITs to best support the position that the trust is a non-grantor trust (realizing that there is not 100% certainty)? Perhaps the safest alternative is to plan the trust so that all it owns is the life insurance policy and non-income producing assets (such as cash in a non-interest bearing

account) so that it will never have taxable income during the grantor's life and prohibit the trustee from using taxable income (including capital gains and accumulated income) to pay premiums. Other possible alternatives include: (i) require the consent of an adverse party to the payment of premiums, or (ii) structure the trust so that a third party other than the grantor, perhaps a sibling or parent, creates the trust and the insured loans assets to the trust at commercially reasonable rates to make the premium payments.

(7) **Section 679 Issues.**

(a) **U.S. Resident as Grantor.** If a U.S. resident person is the grantor and if there is a U.S. resident beneficiary of any portion of the trust, avoid having one-half or more of the trustees who are not U.S. citizens or residents or a U.S. domestic corporation, §679, §677(a), §7701(a)(30)E) & (31)(B).

(b) **Non-U.S. Resident as Grantor.** A trust created by a non-U.S. resident for income tax purposes is a non-grantor trust (unless one of the limited exceptions in §672(f)(2) are satisfied). Being classified as a non-grantor trust in this context is generally undesirable for various tax reasons. Section 679 treats a foreign trust with U.S. beneficiaries as a grantor trust when the grantor becomes a U.S. resident if the grantor becomes a U.S. resident within five years of the contribution to the trust.

(8) **Savings/Interpretation Clause.** Consider including prohibitions on any actions that would cause the trust to be a non-grantor trust, treating such actions as void ab initio. Make clear the grantor's intent that the trust is a non-grantor trust and that the trust should be interpreted in that manner.

(9) **Trustee Changes**. Be *very* careful when trustee changes are made, due to trustee resignations or otherwise. Carefully review the provisions of §674 to assure than an exception to the general rule of §674(a) applies in all circumstances (as to both income and principal).

d. **Other Planning Considerations With Non-Grantor Trusts.** Commentators have discussed a wide variety of other planning considerations for non-grantor trusts. *See* Brent Nelson*, Unleashed Non-Grantor Trust Potential*, 50 ACTEC L.J. 161 (Spring 2025) (including GST tax issues, basis adjustment issues, business arrangements, loans and sales, and BDOT issues); Jonathan Blattmachr & Martin Shenkman, *Flexible Beneficiary Trusts: Reducing Income Tax on Non-Grantor Trusts*, 47 ACTEC L.J. 301 (Spring/Summer 2022).

9. Basis Adjustment Planning

The "permanent" increase of the estate tax exclusion amount to $15 million (indexed) under the Act means that almost all of the population will have no estate tax concerns, but will be entitled to basis adjustments to the date of death value under §1014. Basis adjustment planning takes on added significance in light of the enhanced $15 million (indexed) exclusion amount and because the exclusion amount is indefinite and does not sunset after a period of time. The exclusion amount likely would be reduced only if a future Congress has Democratic majorities in the House and Senate well in excess of a mere greater-than-50% majority.

a. **Asset Classes Benefitting the Least and Most From Basis Adjustment.** Assets that receive no benefit from basis adjustment under §1014 include IRD items and IRAs. Assets receiving minimal to moderate benefit from basis adjustment include qualified small business stock (because a 100% exclusion of gain up to a generous limit is available in any event under §1202), and high basis stock. Assets receiving the most benefit include "negative basis" real estate, assets taking bonus depreciation on qualified property under §168(k) (the recapture of 100% upfront expensing is all ordinary income), and creator-owned copyrights, trademarks, patents, and artwork.

b. **Preserving Basis Adjustment Upon Death of Donor/Settlor.**

(1) **Basis Adjustment for Trust Settlor by Granting Testamentary Limited Power of Appointment**. A very flexible alternative to cause estate inclusion for the trust settlor would be to give an independent party the authority to grant a power to the settlor that would cause estate inclusion, such as a testamentary limited power of appointment, which would cause estate

inclusion under §2038 (i.e., settlor held the power at death to alter, amend, revoke or terminate the interest) and result in a basis adjustment under §1014(b)(9).

To preserve flexibility over whether the assets will or will not be included in the settlor's estate, it is critical that estate inclusion will not result if the power of appointment is not granted. Estate inclusion will not occur under §2038 unless the power is actually granted (as long as no understanding exists that the power will be granted whenever requested by the settlor). "[S]ection 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death …" Reg. §20.2038-1(b). *See Estate of Skifter v. Commissione*r, 468 F.2d 699 (2d Cir. 1972).

Possible inclusion under §2036(a)(2) (i.e., retention for life of the power, alone or in conjunction with any person, to designate who may possess or enjoy the property or the income therefrom) is problematic because the regulations under §2036 do not except powers subject to a contingency beyond the settlor's control. Section 2036, however, applies only to powers to designate who can possess or enjoy income or property "during the decedent's life." Reg. §20.2036-1(b)(3). Therefore, §2036 would not apply to a testamentary limited power appointment.

(2) **Repurchase Appreciated Assets From Grantor Trust.** The grantor may consider swapping high basis assets in return for low basis from the grantor trust (the low basis assets owned by the grantor at death would receive a basis adjustment under §1014). The most conservative approach is for the settlor to transfer cash, or high basis assets. If the grantor does not have ready cash, consider borrowing cash from a third party lender to use to pay the trust. Following the grantor's death, the trust could use the cash to repay the grantor's estate, which could then repay the bank. If none of those are available, the grantor might consider giving the trust a promissory note in return for low basis assets, but in that situation, the trust's basis in the note is unclear.

(3) **Avoiding Valuation Discounts for FLP/LLCs.** One approach to avoid valuation discounts for assets in an FLP is to argue that the assets are included in the decedent's gross estate under §2036(a)(2) under the reasoning of *Powell v. Commissioner*, 148 T.C. 392 (2017) and *Estate of Fields*, T.C. Memo. 2024-90. This position may run into IRS objections, with the IRS arguing that the bona fide sale for full consideration exception prevents the application of §2036(a)(2) and that taxpayers are generally bound by the form of a transaction. *See* Tech. Adv. Memo. 9515003 (IRS rejected taxpayer's argument that voting trust given to an irrevocable trust should be included in the decedent's estate under §2036(a)(2) because of an oral understanding the trustee would vote the stock as desired by the decedent). For a discussion of Tech. Adv. Memo. 9515003 and possible distinctions form the *Powell* situation, see Item 6.e.(11) of Estate Planning Current Developments and Hot Topics (Dec. 2018) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

Another approach is amend the limited partnership agreement to remove transfer restrictions as much as possible, but that probably cannot result in totally eliminating discounts.

Another approach is to convert the limited partnership to a general partnership. If the partners are concerned about liability on the underlying assets, the partners could initially transfer their partnership interests to wholly-owned disregarded entity LLC, and then convert the limited partnership to a general partnership. The state law exception under §2704(b)(3)(B) for restrictions imposed by state law would not apply because state law does not restrict a partner from withdrawing from a general partnership. A person has the power to disassociate as a partner from a general partnership at any time (Uniform Partnership Act §602(a)), and upon disassociation, the partnership is required to purchase the person's interest in the partnership for a price that is the greater of liquidation value or the value based on a sale of the entire business as a going concern without that partner (UPA §701(a)-(b)). At a partner's death, the partnership interest would be stepped up to full value (without discounts) and a §754 election would be made to get a basis adjustment on the inside basis of the partnership assets.

(4) **Donor Use of Property.** The donor uses trust property in some way that would reflect an implied agreement of retained enjoyment to cause estate inclusion under §2036 (such as using property without paying adequate rent). (The court rejected the IRS position, however, that the decedent's continued occupation of a residence without paying rent following the end of the term of a QPRT required inclusion under §2036(a)(1) where the estate demonstrated an intention to pay rent that had not been completed before the decedent died. *Estate of Riese v. Commissioner*, 2011 T.C. Memo. 60.)

(5) **Move Trust Situs**. If the donor is a discretionary beneficiary of the trust in a domestic asset protection (DAPT) state, move the trust situs to a state that does not have DAPT provisions.

(6) **Sell Loss Assets to Grantor Trust.** Sell loss assets to a grantor trust to avoid a step-down in basis at the grantor's death (because the loss assets would not be owned by the grantor at death).

c. **Basis Adjustment for Beneficiary.** Possible strategies to allow a basis adjustment at a trust beneficiary's death include planning for the flexibility:

- to make distributions to the beneficiary (either pursuant to a wide discretionary distribution standard or under the exercise of a non-fiduciary nontaxable power of appointment);
- to have someone grant a general power of appointment to the beneficiary (that possibly could be exercisable only with the consent of some other non-adverse party (but not the grantor); consider using broad exculpatory language for the person who can grant the power of appointment and consider providing that the powerholder has no duty to monitor whether a general power should be granted or possibly provide that the powerholder has no authority to grant a general power until requested by a family member to consider exercising his or her discretion to grant a general power); but query whether the mere authority of a third party to grant a general power of appointment to a beneficiary has the effect of treating the beneficiary as holding a general power of appointment with the consent of a non-adverse party, which would treat the beneficiary as having a general power of appointment whether or not the third party actually grants it? Stated differently, if the power is never granted to the beneficiary, is it treated as a power exercisable upon the occurrence of an event which never happened and thus not a general power of appointment under Reg. §20.2041-3(b), or is it a power exercisable "in conjunction with another person," making it a general power under §2041(b)(1)(C) even though never granted?;
- to use a formula general power of appointment;
- to the extent that general powers of appointment are used for basis adjustment purposes, bear in mind that the existence of the general power may have creditor effects, but the actual exercise of a testamentary general power of appointment may be more likely to subject the assets to the decedent-beneficiary's creditors than if the general power is not exercised; or
- to trigger the Delaware tax trap by the exercise of a nontaxable power of appointment to appoint the assets into a trust of which a beneficiary has a presently exercisable general power of appointment.

For a detailed discussion of these basis adjustment planning alternatives for trust beneficiaries, see Item 5.f of Estate Planning Current Developments and Hot Topics (Dec. 2018) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

d. **Achieving Basis Adjustment at First Spouse's Death Regardless of Which Spouse Dies First; Limitations Under Section 1014(e) If Donee Dies Within One Year.** Alternatives for achieving a basis increase at the first spouse's death include the following. All of these alternatives are discussed in considerably more detail in Item 8 of the Current Developments and Hot Topics Summary (Dec. 2015) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(1) **Community Property.** Spouses in community property states get a basis adjustment on all community property regardless of which spouse dies first. §1014(b)(6). Any separate property

could be converted to community property (through a "transmutation agreement"). *See, e.g.*, TEX. FAM. CODE §4.202; TEX. CONST. Art. XVI, Sec. 4.202. But a question arises as to whether that is a transfer that might trigger §1014(e) if the "recipient" spouse dies within one year.

For couples that do not live in community property states, the spouses might create community property by conveying assets to a "Community Property Trust" permitted under the laws of several states. *See* Joseph Percopo, *Understanding the New Florida Community Property Trust*, FL. B.J. (July/Aug. 2022).

(2) **Joint Trusts**. Some planners have attempted, with varying degrees of success, to use joint trusts as a way of achieving a basis increase whichever spouse dies first. *E.g.* Letter Ruling 200101021 (denying basis increase because of §1014(e)). The strategy has been refined with an alternative that has been termed the Joint Exempt Step-Up Trust ("JEST"). See Alan Gassman, Christopher Denicolo & Kacie Hohnadell, *JEST Offers Serious Estate Planning Plus for Spouses—Parts 1 and 2*, ESTATE PLANNING (Oct. and Nov. 2013).

(3) **Section 1014(e) Limitation if Donee of Gifted Appreciated Assets Dies Within a Year and the Assets Pass Back to the Donor.** Section 1014(e) provides that the basis of property received from a decedent will be equal to the decedent's basis immediately prior to death, rather than its estate tax value, if the property had been given to the decedent within one year before the date of death and if the property passes back to the original donor (or his or her spouse). That provision likely does not apply, however, if the assets do not return "to" the donor.

(4) **Section 2038 Marital Trust.** Another possible strategy to achieve a basis step-up for all marital assets at the death of the first spouse is a "Section 2038 Marital Trust." As an example, H creates an irrevocable trust for W as a discretionary beneficiary (H could be the trustee) providing that on W's death the assets pass to her estate, and providing that H retains the right to terminate the trust prior to W's death and have the assets distributed to W. The assets would be includible in H's estate under §2038 if he dies first (because of his power to terminate the trust early), and would be includable in W's estate under §2031 if she dies first (because the assets would be payable to her estate). For a further discussion of the Section 2038 Marital Trust, see Item 8.e of the Current Developments and Hot Topics Summary (Dec. 2014) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

e. **Upstream Gifts.** A client may give/sell assets to a grantor trust for a third party (such as a modest-wealth parent of the client) who will have a testamentary general power of appointment in the trust. At the parent's death, the inclusion of the assets in his or her estate may generate no estate taxes but the assets would receive a basis adjustment (although issues could arise if the parent dies within a year of when the client creates the trust) and the parent could allocate his or her GST exemption to the assets. The assets might pass by default into a trust for the client's benefit but that would not be in the client's estate for estate tax purposes. For a discussion of what Melissa Willms has referred to as the "accidentally perfect grantor trust," see Item 7.c of the Current Developments and Hot Topics Summary (Dec. 2015) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. *See* Mickey Davis & Melissa Willms*, All About That Basis: How Income Taxes Have Reshaped Estate Planning,* ALI-CLE Planning Techniques for Large Estates (April 2018); Turney Berry, *The "Hook" of Increased Income Tax Basis*, TRUST & ESTATES 10 (April 2018).

Highlights of this planning alternative are briefly summarized below (assuming, for example, the third party is a parent of the client).

- Trust general structure – The parent has a testamentary general power of appointment (this could be a formula general power of appointment to limit the general power to assets that would not cause the parent's estate to exceed the parent's estate tax exemption amount); if not exercised, the assets subject to the general power of appointment remain in trust and the client becomes a discretionary beneficiary (or perhaps could merely be added by some third person as a discretionary beneficiary at a later time).

- Gift tax – The client makes a gift, using the client's gift exemption, but sales to the trust could leverage that exemption.
- Parent's estate tax – Trust assets (including assets sold to the trust) are included in the parent's gross estate under §2041.
- Basis adjustment – A basis adjustment is available under §1014(b)(9) for assets included in the parent's gross estate; even if just the net value of assets sold to the trust under a non-recourse note are included in parent's gross estate under §2041, a basis adjustment is allowed for the full gross value of the assets. §1.1014-10(b)(3)(i). The basis adjustment might be reduced by the amount of depreciation deductions allowed to the client prior to the parent's death. Reg. §1.1014-6.
- Section 1014(e) – If the parent dies within a year of when the client makes the gift to the trust and if the assets pass back to the client, §1014(e) would prevent a basis adjustment. If the assets merely pass to or remain in a trust of which the client is a discretionary beneficiary (or may be added as a discretionary beneficiary by a third person after some point in time), §1014(e) may not apply, in which event a basis adjustment would be allowed,
- Client's estate tax – The client could be a discretionary beneficiary without causing estate inclusion for the client under §2036(a)(1) (because the parent is treated as the transferor as to assets subject to the general power of appointment), as long as the client's state has passed legislation overring the traditional "relation back" doctrine to provide that the client is not treated as the settlor of the trust for creditor purposes (in which event §2038 might apply).
- Grantor trust as to client –The trust would be structured as a grantor trust; following the parent's death, there is a strong argument that the trust continues as a grantor trust as to the client under Reg. §1.671-2(e)(5) if the parent does not exercise the general power of appointment.
- GST tax – The client could allocate GST exemption to the initial gift, or the client might not allocate GST exemption initially, and the parent could allocate his or her GST exemption at the parent's death (when the parent would be treated as the transferor, Reg. §26.2652-1(a)(1)).
- Creditor issues – State law will govern creditor issues, both as to the parent's creditors and as to the client's creditors if the assets remain in the trust with the client as a discretionary beneficiary after the parent's death. Some states that do not have DAPT legislation nevertheless provide that assets that pass to a trust for the client (either by the exercise of a general power of appointment or upon the unexercised lapse of a general power of appointment) will generally be protected from claims of the client's creditors. *E.g.,* TEX. PROP. CODE §112.035(g)(3)(B).

Could the trust be designed as a revocable trust, giving the third party a testamentary general power of appointment? Using a client-parent scenario, the gift would be incomplete, so the client would not have to use gift exemption initially. But the gift would be completed at the parent's death (as long as the testamentary general power of appointment could not be revoked) and the parent would make a gift at that time. (If the client could revoke the general power of appointment after the third-party's death, the gift would not be completed, but the assets would not be includible in the parent's gross estate under §2041. *See Merchants National Bank of Mobile, as Executor Under Will of Nettie F. Turner*, 261 F.2d 570 (5th Cir. 1958) (dictum that any outstanding contingency, like a revocation power, precludes inclusion under the predecessor of §2041 in the power holder's estate unless the contingency is resolved at or prior to the power holder's death); Mitchell Gans, Jonathan Blattmachr & Austin Bramwell, *Estate Tax Exemption Portability: What Should The IRS Do? And What Should Planners Do In The Interim*, 42 REAL PROP., PROB. & TR. L.J. 413, 424- 27 (Fall 2007). This revocable trust approach can work fine if neither the grantor nor the beneficiary is concerned with using his or her gift exclusion amounts. If the client has transfer tax concerns, a better way to minimize the use

of the client's gift exemption with the upstream planning alternative is to make a relatively small gift and build the trust value with sales to the trust of appreciating assets.

"BDOT" provisions could be incorporated into the upstream trust planning, to assure that the grantor would continue to be treated as the deemed owner of the trust the trust for purposes of the grantor trust rules, whether or not the parent exercises the general power of appointment.

Similarly, a beneficiary of a trust who has a limited power of appointment might appoint the assets to a trust in which a third party (such as a modest-wealth parent) has a testamentary general power of appointment. The assets would receive a basis adjustment at the parent's death, hopefully no estate taxes would be payable by the parent's estate, and the parent's executor could allocate the parent's unused GST exemption to the assets. "BDOT" provisions could be used to treat the parent or the future beneficiary of the trust as the deemed owner under §678.

f. **GST Tax Impact.** Basis adjustment planning considerations for trusts is important particularly for GST-exempt trusts. For non-exempt trusts, if a taxable termination occurs at a beneficiary's death (for example, when the last non-skip person dies), a GST tax is imposed and a basis adjustment is allowed. §2654(a)(2).

10. Testamentary Planning

a. **Very Small Percentage of Population Subject to Transfer Taxes.** "In filing year 2001, nearly 52,000 estates owed a total of $23.5 billion in taxes. Twenty years later, just under 1,300 taxable estates were taxable, owing a collective $9.3 billion." Penn Wharton Budget Model, *Decomposing the Decline in Estate Tax Liability Since 2000* (July 28, 2022). The percentage of American decedents owing estate tax has fallen to about 0.7% (and that is before the exemption will increase to $15 million in 2026). *See* Jeanne Sahadi, *New Tax Law Increases Big Beyond-The-Grave Tax Break for the Wealthy*, CNN BUSINESS (July 20, 2025). The Urban-Brookings Tax Policy Center estimates that approximately 4,000 taxable estate tax returns were filed in 2023. The Institute on Taxation and Economic Policy estimates that the estate tax raised just $30 billion in 2024, a miniscule amount compared with the nearly $50 trillion in wealth held by the top 1% of Americans. *See* Ray D. Madoff, *A Signature GOP Issue Is Omitted From Trump's 'Big' Tax Bill. Weird*, WASHINGTON POST (June 30, 2025). This means that many individuals have no concern with lifetime gifts ever resulting in the payment of federal gift taxes. Wealthy clients still exist, though, and the wealthy are getting wealthier.

On the other hand, non-resident alien individuals are still subject to estate taxes. The exclusion amount remains at $60,000 (*see* §2102(b), specifying a unified credit of $13,000, which is the amount of tax on a $60,000 estate)).

Even low to moderate-wealth individuals cannot ignore the GST tax. Without proper allocation of the GST exemption (also $15 million, indexed, beginning in 2026), trusts created by clients generally will be subject to the GST tax at the death of the beneficiary unless the trust assets are included in the beneficiary's gross estate. The GST exemption might be allocated automatically under the automatic allocation rules, but the GST tax status of all trusts should be addressed.

b. **Review Formula Clauses.** Review formula clauses in existing documents that could inadvertently have the effect of leaving most of the estate to a credit shelter trust or have other unexpected effects.

c. **Changes to Existing Trusts.** Clients who are no longer subject to transfer taxes may wish to change existing trusts that are designed to save transfer taxes. The client may want the assets to be distributed to beneficiaries, feeling that saving transfer taxes for the beneficiaries is no longer important. Or the client may wish to re-acquire the trust assets so the client can enjoy them during the client's life and can obtain a basis adjustment at the client's death. Alternatives include making distributions within the trust distribution standards, amending the trust by someone holding an amendment power, appointing assets to individuals (or other more appropriate trusts) under a power of appointment, using judicial or non-judicial modification proceedings, or having an individual exercise a substitution power or otherwise purchasing "favored" assets from the trust. At a

minimum, the client may want to "turn off" grantor trust status so the client does not have to paying income taxes on the trust's income.

d. **Testamentary Planning Structuring Approaches**. What testamentary planning approaches are preferred for couples with combined assets well under the approximately $30 million estate tax exclusion amounts available to the spouses (beginning in 2026)?

As an overview of general planning themes depending on the size of the estate of a married couple:

(1) Couples with assets under $15 million – address whether assets will be left outright to the surviving spouse, outright to the spouse with a possible disclaimer into a trust, or directly in trust, and cause estate inclusion at the surviving spouse's subsequent death to receive a basis adjustment;

(2) Couples with assets over $15 million but less than $30 million – make use of the first decedent-spouse's exclusion amount with an outright gift with disclaimer planning or a QTIPable trust approach, creating flexibility through the manner in which the portability election is made (the portability election could create the possibility of using both spouses' exclusion amounts but allowing a basis adjustment of all of the estate assets at the second spouse's death); and

(3) Couples with assets over $30 million – same as category 2 but also consider gifts using some of the increased gift exclusion amount to save estate tax and consider making transfers in a way that one of both spouses have potential access to some of the transferred assets for clients making large transfers.

e. **Increased Importance of Portability**. Unless strong reasons exist to use credit shelter trusts in $15 million and under estates, relying on portability to take advantage of the first spouse's estate exclusion amount is increasingly helpful. A tax advantage of relying on portability rather than creating a bypass trust is that the surviving spouse has both spouses' exclusions to cover any estate taxes that might apply, but a basis step-up is achieved at both spouses' deaths.

The decision of whether to create a bypass trust following the first spouse's death can be delayed until after the first spouse has died by using a disclaimer approach or using a QTIPable trust, so that the tax law and factual situation at that time can be considered.

Some factors favoring the creation of a credit shelter trust at the first spouse's death could include if (i) a likelihood or significant possibility of substantial appreciation of estate assets after the first spouse's death and the federal estate tax might apply to the surviving spouse's estate, (ii) a state estate tax, (iii) a younger client scenario (in which remarriage of the surviving spouse is likely), and (iv) a situation in which the couple wants to use trusts after the first spouse's death and wants to have both the surviving spouse and descendants as discretionary beneficiaries of the trust (although the surviving spouse may be able to receive trust distributions from a QTIP trust and make gifts to younger family members as desired in light of the increase gift tax exclusion amount). The credit shelter trust may also be advantageous for various reasons in blended family situations, as discussed in Item 8.d the Current Developments and Hot Topics Summary (Dec. 2013) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

If the QTIP approach is used in connection with portability, in light of the wide ranging factors that must be considered and the inherent uncertainties involved with the portability decision, documents should provide broad exculpation to the fiduciary who must make the QTIP election.

f. **Flexible QTIP Trust Approach**. A favored approach of many planners for testamentary planning for couples will be the use of QTIP trusts, and that approach can be used for any size of estate if the clients want to use trust planning after the first spouse's death [or if the transfer tax does not apply], which affords great flexibility. QTIP planning could use a single QTIP plan, or multiple QTIP trusts (for example, if a state estate tax applies with an exemption different than the federal estate tax exclusion amount). An advantage of the single QTIP drafting approach is that the client (hopefully) can understand it, just realizing that it leaves a great deal of flexibility after the first spouse has died.

Portability would be used if a full QTIP election is made (and the first deceased spouse's GST exemption could be used by making a reverse QTIP election under §2652(a)(3)), and a bypass trust approach would be used if a partial QTIP election (likely a formula election) is made.

The trust could include a Clayton provision allowing more flexible terms if the QTIP election is not made. Alternatively, the unelected QTIP trust could remain as a single-beneficiary mandatory income trust for the spouse. The amount of income paid to the spouse could be managed by the asset selection for the trust.

g. **QTIPable Trust With Delayed Power of Withdrawal**. If the clients want to have the flexibilities afforded by using a QTIP trust (*e.g.*, to have 15 months to decide what QTIP election to make, to make a formula QTIP election, etc.) but still want the spouse to have an unlimited withdrawal power, consider creating a standard QTIP trust but including a delayed withdrawal power. The trust is a general power of appointment trust qualifying for the marital deduction only if the surviving spouse's power of appointment exists immediately following the decedent's death. Reg. §20.2056-5(a)(4) ("must be exercisable in all events") & §20.2056-5(g)(1). For example, provide that the power of withdrawal arises sometime after estate tax filing date. Any limitations desired on the amount of the withdrawal right could be added (*e.g.,* up to 20% each year).

h. **Emphasis on Flexibility.** Building in flexibility to trust arrangements will be important. Provisions included in trusts to avoid estate taxes may be unnecessary (and not desirable) for settlors or beneficiaries who have no estate tax concerns. Some of the ways of adding considerable flexibility are:

- using nontaxable powers of appointment;
- providing broad distribution standards by independent trustees;
- granting substitution powers to the settlor; and
- providing special modification powers to trust protectors (see Item 3(h)(8)-(11) of the Current Developments and Hot Topics Summary (November 2017) found **here** and available at **www.Bessemer.com/advisor** for a more detailed discussion of powers and limitations that can be added for trust protectors to provide flexibility).

i. **Further Discussion.** For a more detailed discussion of these testamentary planning structuring issues, as well as a discussion of transfer and freeze planning issues in light of the greatly increased gift and estate exclusion amounts, see Item 3 of Estate Planning Current Developments and Hot Topics (Dec. 2018) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

11. Resources

For a more detailed discussion of the background behind the legislative "sausage-making" leading up to enactment of the Act (up until the time that Act was under final consideration in the Senate) see Item 2.b and c of LOOKING AHEAD – Estate Planning in 2025 & Current Developments (Including Observations from Heckerling 2025) (June 30, 2025) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

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

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

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

Executive Order 14192, titled "Unleashing Prosperity Through Deregulation" dated January 31, 2025, revives the OIRA review of tax regulations, reinstating the April 11, 2018 memorandum of agreement between the Treasury and OMB to allow OIRA to review proposed regulations. The order also says "[u]nless prohibited by law, whenever an executive department or agency … publicly proposes for notice and comment or otherwise promulgates a new regulation, it shall identify at least 10 existing regulations to be repealed." However, perhaps the concern is primarily with incurring no net incremental costs rather than necessarily repealing 10 existing regulations. The order adds that in connection with the direction to repeal 10 regulations for every new regulation: "any new incremental costs associated with new regulations shall, to the extent permitted by law, be offset by the elimination of existing costs associated with at least 10 prior regulations." *See* Slowey, *Tax Rules to Undergo White House Review After Trump Revives Order*, BLOOMBERG DAILY TAX REPORT (Feb. 3, 2025).

Executive Order 14219 dated Feb. 19, 2025, titled "Ensuring Lawful Governance and Implementing the President's 'Department of Government Efficiency' Regulatory Initiative," charges agency heads to identify the following types of regulations:

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

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

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

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

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

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

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

The first three of those items seem directly related to the *Loper Bright* Supreme Court decision overruling the *Chevron* doctrine, discussed in Item 22 below. With another nod to *Loper Bright*, section 3 of the executive order also directs that "agencies shall preserve their limited enforcement resources by generally de-prioritizing actions to enforce regulations that are based on anything other than the best reading of a statute and de-prioritizing actions to enforce regulations that go beyond the powers vested in the Federal Government by the Constitution."

A Presidential Memorandum dated April 9, 2025, titled "Directing the Repeal of Unlawful Regulations," requires federal agencies to identify unlawful regulations within 60 days and take steps to repeal them without notice and comment. The Memorandum says the principles of various specific cases should be applied (and one of those cases is the *Loper Bright* case). For a detailed discussion of implications of that Presidential Memorandum, see Jasper Cummings, Jr., *Latest Priority Guidance Plan is New in Every Sense*, 187 1025 TAX NOTES FEDERAL (May 12, 2025). Among other things, that article suggests that the Priority Guidance Plan for 2025-2026 may change dramatically, in part because of the order that a proposal of a new regulation must identify at least 10 existing regulations that it will repeal. It also suggests that we will see fewer and the completion of fewer guidance projects from the IRS: "This time, it is crystal clear that guidance is not valued, so finishing projects will not be rewarded, unless they are projects of particular interest to the administration, probably tied to the 2025 legislation." *Id*. Indeed, as discussed below, the 2025-2026 Priority Guidance has far fewer projects than in many prior years.

Some agencies have responded to that directive by seeking to invalidate certain regulations by invoking the Supreme Court's "major questions doctrine," which bars agencies from acting on issues of vast economic and political significance without clear congressional authorization. *West Virginia v. EPA*, 597

U.S. 697 (2022). *See* Robert Iafolla, *Trump Seeks Lasting Deregulation by Disavowing Agency Authority*, BLOOMBERG DAILY TAX REPORT (Aug. 25, 2025) (invalidating a regulation under the major questions doctrine would prevent a future administration from undoing that invalidation without congressional action clearly authorizing the approach taken in the invalidated regulation; also deregulating based on legal authority takes much fewer resources and much less time than a more traditional policy-based deregulation – "to deregulate based on legal authority, all you need is a couple of lawyers in a room").

The Trump administration on September 4, 2025, re-released its spring 2025 regulatory agenda, adding more than 30 proposed rules that were not on the Fall 2024 regulatory agenda and including a catch-all rule to "remove or amend existing tax regulations with the goal of reducing regulatory burden for taxpayers."

These changes by the Trump administration have led one commentator to suggest that the IRS-Treasury priority guidance business plan process should be shelved, at least while these restrictions are in effect, and that this process of eliminating regulations may lead to legal uncertainties. Monte Jackel, *Does the IRS Still Need a Priority Guidance Plan?*, 186 TAX NOTES FEDERAL 1875 (Mar. 10, 2025); Monte Jackel, *Trump's Revocation of 'Unlawful' Regulations is a Legal Quagmire*, TAX NOTES TODAY FEDERAL (May 14, 2025).

a. **2025-2026, 2024-2025, 2023-2024, 2022-2023 and 2021-2022 Treasury-IRS Priority Guidance Plans.** The 2025-2026 Treasury-IRS Priority Guidance Plan (dated September 30, 2025) sets the priority for guidance projects during the Plan year (from July 1, 2025, to June 30, 2026), but no deadline is provided for completing the projects.. The 2025-2026 Plan is dramatically different than prior Plans, containing just 105 projects (down from 231 projects in the 2024-2025 Plan), 11 of which have already been released or published. The 2025-2026 Plan reflects the Treasury Department's and IRS's focus on five key areas: (1) implementation of the Act; (2) deregulation and burden reduction; (3) Tribal tax issues; (4) digital assets; and (5) SECURE 2.0 Act. Many projects that were on the 2024-2025 Plan are not included on the new Plan because they do not fit into one of those focus categories. "Some of those projects may be considered for inclusion on a future priority guidance plan."

   Forty items are included related to implementation of the Act. Some of those include guidance regarding qualified tips, overtime compensation, Trump accounts, qualified business income, special depreciation allowance for qualified property under §168(k and §168(n)), research and experimental expenditures, business interest deduction, credit for contributions to scholarship granting organizations, enhancements to §529 plans, excise tax on certain private colleges and universities, excess compensation paid by certain tax-exempt organizations, qualified opportunity zone enhancements, gain exclusion for sale or exchange of qualified small business stock (§1202), and gains from sale of certain farmland property (§1062).

   The 2025-2026 Plan includes the following transfer tax issue: "Regulations under §2010 regarding extension and enhancement of increased estate and gift tax exemption amounts and related issues." It is not clear what that is referring to. Perhaps it is the anti-abuse exception for the anti-clawback regulation (see Item 14 below), but that seems to be a low priority issue now that there is little likelihood of the basic exclusion amount at death being reduced to less than the exclusion amount when gifts were made, Furthermore, this description is different than the more specific provision that was in the 2024-2025 plan about the anti-abuse exception: "Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of §20.2010-1(c). Proposed regulations were published on April 27, 2022."

   All of the 12 provisions in the 2024-2025 Plan in the "Gifts and Estates and Trusts" section (discussed below) were omitted from the 2025-2026 plan (five of those projects were completed in 2024 or 2025, namely numbers 2, 7, 10, 11, and 12).

   The 2024-2025 Plan added three new projects in the "Gifts and Estates and Trusts" section.

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

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

(3) Guidance updating the user fee for estate tax closing letters (Number 12). (The IRS issued interim final regulations The project about establishing a user fee for estate tax closing letters (Reg. §300.13 (T.D. 9957)) was addressed on September 27, 2021, effective October 28, 2021, by imposing a $67 user fee. Charging a user fee for closing letters was apparently viewed by some in the IRS as the only way to keep issuing them at all. The IRS has corrected a lot of issues with the closing letter system. Closing letters are obtained through pay.gov. The user fee to request an estate tax closing letter has been reduced from $67 to $56. Final regulations (T.D. 10038, RIN 1545-BR22) making that change were issued on Nov. 28, 2025 and published in the Federal Register on Dec. 1, 2025, finalizing without change the text of interim final regulations (T.D. 10031) and proposed regulations (REG-107459-24) published in May 2025.

The 2024-2025 Plan deleted one project in the "Gifts and Estates and Trusts" section that was finalized in the last Plan year, extensions to allocate GST exemption (final regulations (RIN 1545-BH63) were published on May 6, 2024, discussed in Item 15 below. In addition, Item 7 on the 2024-2025 Plan said that references in Reg. §20.2056A-2 regarding qualified domestic trust elections on estate tax returns were updated in proposed regulations filed August 20, 2024 (Number 6 in the 2023-2024 Plan).

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

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

GIFTS AND ESTATES AND TRUSTS

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

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

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

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

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

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

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

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

8. Regulations under §2632 providing guidance governing the allocation of generation-skipping transfer (GST) exemption in the event the IRS grants relief under §2642(g), as well as addressing the definition of a GST trust under §2632(c), and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining exemption.

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

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

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

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

Five of those 12 projects were completed in 2024 or 2025, namely numbers 2, 7, 10, 11, and 12). Several of the items on the Plan (and on Plans from the last several years) are discussed in more detail below.

Proposed regulations were issued in 2022 with respect to two of the items on the Plan (Numbers 3 [abuse exception to the anti-clawback regulation], and 5 [§2053]). Final regulations were issued for the GST exemption allocation extensions project (Number 8 on the 2023-2024 Plan and deleted in the 2024-2025 Plan) on May 3, 2024. See Item 15 below. The basis consistency final regulations, proposed regulations updating obsolete QDOT references, and §2801 final regulations regarding gifts or bequests from covered expatriates have been completed.

b. **Basis Consistency (Number 2).** The basis consistency provisions of §1014(f) and §6035 were enacted as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, enacted July 31, 2015, applicable to estates for which estate tax returns are filed after the date of enactment (i.e., after July 31, 2015). Form 8971 and its instructions were updated in a version dated August 2025 to reflect changes made in the final regulations. For a detailed discussion of the final regulations, see Item 13 below.

c. **Anti-Abuse Exceptions to Anti-Clawback (Number 3).** Number 3 addresses the anti-abuse exception to the clawback regulation. The IRS released proposed regulations on April 26, 2022, discussed in Item 14 below.

d. **Alternate Valuation Period (Number 4).** This project has been on the Plan for a number of years. For further discussion of this project see Item 6.d of Estate Planning Current Developments and Hot Topics (December 2019) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** There were informal indications that these final regulations may be among the next projects that will be completed in the gifts and estates area, but they are not on the 2025-2026 Plan and apparently will not be issued anytime soon.

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

The proposed regulations address four general topics about deductions for claims and administration expenses under §2053: (1) applying present value concepts, (2) deductibility of interest, (3) deductibility of amounts paid under a decedent's personal guarantee, and (4) curing technical problems of references in existing regulations to a "qualified appraisal" for valuing claims by instead describing requirements for a "written appraisal document." For a detailed discussion of the proposed regulations, see Item 7 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For a summary of the especially important provisions about applying present value concepts and the deductibility of post-death interest, see Item 6 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

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

g. **GST Exemption Allocation (Number 8).** Proposed regulations regarding §2642(g) were published on April 17, 2008 (REG-147775-06). Final regulations were published on May 6, 2024 (89 Fed. Reg. 37116-37127), discussed in Item 15 below.

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

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

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

AOD 2024-01, 2024-52 IRB 1354.

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

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

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

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

j. **Inflation Adjustments.** Inflation adjustments using the C-CPI-U numbers published by the Bureau of Labor Statistics and based on information through August 31 (typically available in mid-September of each year) for 2021, 2022, 2023, 2024, 2025, and 2026 were announced in Rev. Proc. 2020-45, Rev. Proc. 2021-45, Rev. Proc. 2022-38, Rev. Proc. 2023-34, Rev. Proc. 2024-40, and Rev. Proc. 2025-32, respectively. Some of the adjusted amounts for 2026 are as follows:

- Basic exclusion amount and GST exemption –$15,000,000 under the Act; the amounts for earlier years were $13,990,000 in 2025, $13,610,000 in 2024, $12,920,000 in 2023, $12,060,000 in 2022, $11,700,000 in 2021;
- Gift tax annual exclusion – $19,000 in 2026 (same as in 2025), $18,000 in 2024, $17,000 in 2023, $16,000 in 2022, $15,000 in 2018-2021 (observe that the annual exclusion was $15,000 for four years [2018-2021], but it increased by $1,000 in each of 2022-2025;
- Estates and trusts taxable income for top (37%) income tax bracket – $16,000 in 2026, $15,650 in 2025, $15,200 in 2024, $14,450 in 2023, $13,450 in 2022, $13,050 in 2021;
- Top income tax bracket for individuals – $768,700/$640,600(married filing jointly/single) in 2026, $751,600/$626,350 in 2025, $731,200/$609,350 in 2024, $693,750/$578,125 in 2023, $647,850/$539,900 in 2022, $628,300/$523,600 in 2021;
- Taxable income threshold for §199A qualified business income – $403,500/$201,750 (married filing jointly/single) in 2026, $394,600/$197,300 in 2025, $383,900/$191,950 in 2024, $364,200/$182,100 in 2023, $340,100/$170,050 in 2022, $329,800/$164,900 in 2021;
- Standard deduction – $32,200/$16,100 (married filing jointly/single) in 2026, $30,000/$15,000 in 2025, $29,200/$14,600 in 2024, $27,700/$13,850 in 2023, $25,900/$12,950 in 2022, $25,100/$12,550 in 2021;
- Non-citizen spouse annual gift tax exclusion – $194,000 in 2026, $190,000 in 2025, $185,000 in 2024, $175,000 in 2023, $164,000 in 2022, $159,000 in 2021;
- Section 6166 "two percent amount" – $1,940,000 in 2026, $1,900,000 in 2025, $1,850,000 in 2024, $1,750,000 in 2023, $1,640,000 in 2022, $1,590,000 in 2021; and
- Special use valuation reduction limitation – $1,460,000 in 2026, $1,420,000 in 2025, $1,390,000 in 2024, $1,310,000 in 2023, $1,230,000 in 2022, $1,190,000 in 2021.

k. **IRS Tweaking Estate and Gift Tax Returns for e-Filing; Revised Gift Tax Return for Reporting 2024 Gifts.** The IRS is in the process of making some changes to estate and gift tax returns as it plans for allowing e-filing of estate and gift tax returns. This is part of the IRS's goal to go paperless by the 2025 filing season. Some estate tax returns span thousands of pages and are shipped in boxes to the IRS. "The bevy of exhibits and attachments that often accompanies estate and gift tax returns makes the transition from paper to electronic filing of those returns a challenge." Attachments often have "unstructured data" that is not easily converted to a digital format. *See* Jonathan Curry, *ABA Section of Taxation Meeting: E-Filing Could Prompt Tweaks to Estate and Gift Tax Returns*, 182 TAX NOTES FEDERAL 961 (Jan. 29, 2024).

The Form 709 was changed for reporting 2024 gifts. A brief summary of changes in the 2024 Form 709 is in Item 18 below. The Form 706 was changed for decedents dying after 2024, as described briefly in 18 below.

l. **Legal Effect of Proposed Regulations.** This item mentions various proposed regulations that have been issued in response to items that have appeared on Priority Guidance Plans. Bear in mind that proposed regulations do not become effective until final regulations are issued, and typically they take effect as to transactions occurring after that time. (On rare occasions, proposed regulations state they will apply, once the regulations are finalized, as to transactions after the date the proposed regulations are released. The anti-abuse proposed regulation regarding the anti-clawback rule takes that approach, as described in Item 14 below.) While planners may be concerned about provisions in proposed regulations, bear in mind that "proposed regulations, … unlike final regulations, absolutely don't have the force of law. Thus, taxpayers can't be penalized in any way for failing to follow them …." Redd, *What Basis Consistency Regulations?*, TRUSTS & ESTATES 8, at 10 (May 2022). The article by Clary Redd cites very interesting comments in several cases about proposed regulations:

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

Id. at n.15.

13. Basis Consistency Final Regulations

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

Form 8971 and its Instructions were updated in versions dated August 2025 to reflect changes in the final regulations (discussed below). Updated information about Form 8971 is posted at **https://www.irs.gov/forms-pubs/about-form-8971**.

Temporary and proposed regulations regarding §1014(f) and §6035 were published in the Federal Register on March 4, 2016. Various provisions in the proposed regulations were very controversial. The IRS received over thirty written comments about the proposed regulations. ACTEC filed very detailed comments on May 27, 2016, and ACTEC representatives testified at the hearing with the IRS about the proposed regulations. Final regulations were issued on September 16, 2024, and published in the Federal Register on September 17, 2024. (T.D. 9991, 89 FED. REG. 76356, Sept. 17, 2024).

For a detailed discussion about the legislative history behind the basis consistency provisions, the Form 8971, and the proposed regulations, see Item 5.b of Aucutt, *Washington Update: Pending and Potential Administrative and Legislative Changes* (Mar. 2024) found **here** and Akers**,** *Basis Consistency Temporary and Proposed Regulations* (Mar. 25, 2016) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights** and Akers, *The Executor's Job Gets Tougher: Basis Consistency and Selected Other Income Tax Issues Facing Executors*, 51st ANN. HECKERLING INST. ON EST. PL. ¶1803.1 (2017).

b. **Overview of Changes and Clarifications in Final Regulations.** The AICPA Society sent a letter to IRS officials suggesting several issues that should be clarified if the IRS revises Form 8971 and its instructions. The letter listed an excellent summary of helpful changes and clarifications in the final regulations:

- Removed the zero-basis rule;
- Provided guidance on charitable/marital deduction property;
- Clarified that retirement plans are excepted assets;
- Clarified that loan forgiveness to a beneficiary is an excepted asset;
- Provided an ability to defer reporting until actual distribution (which addressed our concern about not knowing which beneficiaries will get particular assets);
- Clarified that the executor is not responsible for determining the allocation of uniform basis when two or more beneficiaries actuarially share an asset; and
- Provided guidance on requirements for supplemental filings due to audit changes.

AICPA Seeks Additional Guidance on Estate Tax Form, TAX NOTES TODAY FEDERAL (May 2, 2025) (Letter dated April 30, 2025, from Blake Vickers, AICPA Tax Committee Chair to IRS Officials; suggesting that instructions clarify when it is necessary to file a supplemental Form 8971 and Schedules A and clarify whether a Schedule A need to be provided to a previously revocable trust included in a decedent's estate within 30 days of filing Form 706).

An additional helpful change in the final regulations is the clarification limiting reports required for subsequent transfers of property received from a decedent. Some of these changes are discussed in more detail below.

c. **Detailed Summaries of Selected Provisions in Final Regulations.** For a detailed summary of selected provisions of the basis consistency final regulations, see Item 4.b of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (Dec. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. Topics discussed include:

- Due date for statements to beneficiaries reporting property the beneficiaries have not yet acquired;
- Removal of zero basis rule for unreported property;
- Eliminating the subsequent transfer reporting requirement for all beneficiaries other than trustees;
- Ability of beneficiaries to challenge value;
- Excepting certain types of property from consistent basis and/or reporting requirements;
- Information returns and supplemental information returns;
- Penalties;
- Property subject to debt; and
- Effective date of regulations.

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

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

b. **General Anti-Clawback Rule.** If a client made a $12 million gift in 2022 (when the gift exclusion amount was $12.06 million) but dies in 2026, assuming the basic exclusion amount has sunsetted to $5 million indexed (say $7 million), the $12 million is added into the estate tax calculation as an adjusted taxable gift, but the estate exclusion amount is only $7 million. So, will estate tax be owed on the difference? The special anti-clawback rule in Reg. §20.2010-1(c)(1) allows the estate to compute its estate tax credit using the higher of the BEA applied to gifts made during life or the BEA

applicable on the date of death. Therefore, in the example above, if the donor dies when the BEA is $7 million, the $12 million gift would be included in the estate tax calculation as an adjusted taxable gift, but the available exclusion amount would be the larger of the $7 million BEA at the date of death or the $12 million of BEA applied to gifts made during life, the larger of those being $12 million. For a detailed discussion of the estate tax calculation process and the operation of the anti-clawback special rule, see Item 4 of Estate Planning Current Developments and Hot Topics (December 2019) found **here**, and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

Observe that the anti-clawback rule and the anti-abuse exception to the anti-clawback rule will be operative only if the estate tax basic exclusion amount is at some point reduced to an amount below the gift exclusion amount that has been applied to prior gifts.

The 2024-2025 Priority Guidance Plan included a provision specifically about these anti-abuse regulations, but that item was dropped from the 2025-2026 Plan. No urgency exists about these regulations now that the estate and gift exemption amount apparently will not be reduced for some time. (The 2025-2026 Plan does include a section generally about "regulations under §2010 regarding extension and enhancements of increased estate and gift tax exemption amounts and related issues," but it is not clear what issues that is referring to.)

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

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

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

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

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

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

15. GST Exemption Allocations Final Regulations

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

Proposed regulations regarding §2642(g) were published on April 17, 2008 (REG-147775-06). Now, sixteen years later, final regulations have been issued. Reg. §26.2642-7, §301.9100-2(f), §301.9100-3(g). The final regulations (RIN 1545-BH63) were approved March 12, 2024, were released on May 3, 2024, and were published on May 6, 2024 (89 Fed. Reg. 37116-37127). A variety of changes (mostly rather minor) have been made between the proposed and final regulations. Some of the major changes are briefly summarized in Item 4.i of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

An interesting effect of allowing election extensions under Reg. §26.2642-7 rather than under 9100-3 relief is that the user fee for ruling requests is now $43,700 (for requests received after February 1, 2025) compared to the $14,500 user fee that applies to requests for extensions of time for regulatory elections under §301.9100-3 that previously applied to GST exemption late election extension requests.

An article provides interesting insights regarding the manner in which the IRS has exercised this discretionary authority in private letter rulings under the new regulations. Steven Bonneau, *PLRs Reveal Pointers for Fixing Inadvertent §2632 Elections*, BLOOMBERG DAILY TAX REPORT (Oct. 3, 2025). Insights include the following.

- Section 2632(c)(5)(a)(1) allows an individual to elect not to have the automatic allocation rules apply to transfer to a trust (an "election out"), and §2632(c)(5)(a)(2) allows an individual to treat a trust as a "GST trust" so that the automatic election rules will apply to transfer to the trust (an "election in").
- The final regulations removed a sentence in the proposed regulations explicitly stating that relief will not be granted to revoke an election under §2632(b)(3) or (c)(5) made on a timely filed federal gift or estate tax return. The preamble to the final regulations gave the following explanation.

  > No statute, however, provides that an election made under section 2632(b)(3) or (c)(5) is irrevocable.
  >
  > Accordingly, proposed §26.2642-7(e)(1), redesignated in the final regulations as §26.2642-7(e)(2), does not include the statement that relief is not available to revoke an election under section 2632(b)(3) or (c)(5) made on a timely filed Federal gift or estate tax return. Such relief may be available provided that the requirements of §26.2642-7 of these final regulations are satisfied.

- The IRS rulings could either (1) allow an extended time for manual allocation of GST exemption as if timely made, or (2) allow a revocation of the prior election (either of which achieves the same favorable result). IRS rulings have used the first alternative (although the rulings have not indicated whether the donors, in seeking relief, initially requested an extension of time to make a different election (such as "electing in" to automatic allocation under §2632(c)(5)(A)(ii) to reverse a prior "election out" of automatic allocation).
- Even though the preamble to the final regulations about allowing relief for prior inadvertent regulations referred to §2632(c)(5), which refers both to elections in and elections out of automatic allocation, no relief appears to be available under §2642(g)(1) for a prior inadvertent election in (i.e., electing to treat a trust as a "GST trust" to which automatic allocation applies).
- PLR 202539002 (issued on July 1, 2025) denied an executor's request for relief under §2642(g) to go back in time and manually (or affirmatively) allocate GST exemption where that would have required the Service to allow the executor to decrease a subsequent manual allocation of GST exemption made on the decedent's Form 706. The PLR stated that under Reg. §26.2642-7(e)(2)(i)

  > relief will not be granted to the extent that it would decrease or revoke an affirmative (but not automatic) allocation of GST exemption under §2632(a) or 2642(b) that was made on a Federal gift or estate tax return,

regardless of whether the transfer or the allocation of exemption was made during the transferor's life or upon the transferor's death.

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

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

b. **New Chapter 15.** The estate and gift tax provisions of the Code are in chapters 11-14. New chapter 15 consists solely of §2801. Section 2801 very generally imposes a tax on certain transfers of property by gift (covered gifts) and on certain transfers of property by bequest (covered bequests) from certain individuals who expatriate on or after June 17, 2008 (covered expatriates).

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

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

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

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

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

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

A "covered expatriate" (as defined in §877A(g)(1)) is an expatriate, i.e., any U.S. citizen who relinquishes citizenship or any green card holder whose status is revoked or abandoned at a time when the person was a lawful permanent resident of the United States in at least 8 of the past 15 years, who expatriates on or after June 17, 2008 and who meets at least one of the following criteria: (i) net income test--average annual U.S. income tax liability over the five years preceding expatriation exceeds a certain threshold ($206,000 for 2025); (ii) net worth test-- had a worldwide

net worth of $2 million or more at the time of expatriation; or (iii) certification test--failed to certify under penalties of perjury that she or he was in compliance with all U.S. federal tax obligations for the preceding five years. Certain individuals are exempt from being classified as covered expatriates (persons who have not lived in the U.S. for specified periods of time and who are born as dual citizens or persons who relinquish U.S. citizenship before reaching age 18 ½. (In addition to the special tax imposed on recipients of gifts or bequests from covered expatriates, covered expatriates are also subject to an "exit tax" under §877A when they expatriate. The overall goal of these provisions in the HEART Act is to remove tax incentives from expatriating.)

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

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

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

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

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

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

vBc99YP74qxJ8dHG7LM3qvIY312eeOoDgaK_sqhrXIgKyAqsfw&_hsmi=342824446&utm_content=342824446&utm_source=hs_email.

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

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

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

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

e. **Form 708.** Cathy Hughes, with the Treasury Office of Tax Legislative Counsel, reported at an American Bar Association Tax Section meeting on May 9, 2025, that IRS and Treasury are far along in developing Form 708. She said that no reports will be required before June 2027, and she hopes to get the form into review by the end of 2025. As to the uncertainty about reporting covered gifts or bequests received after June 17, 2008 and December 31, 2024, Ms. Hughes said the statute does not have a due date, and "since the regulations don't apply, there are no penalties or interest regardless of the filing date with regard to receipts prior to 2025." *See* Nathan Richman, *Expat Gift Reporting Coming Along*, TAX NOTES TODAY FEDERAL (May 12, 2025).

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

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

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

a. **Overview.** The SECURE Act made various changes regarding retirement benefits, including (i) changing the required beginning date (RBD) for required minimum distributions (RMDs) (April 1 of the following year) from age 70½ to 72 (and SECURE 2.0 changes it to age 73 beginning in 2023 and to age 75 beginning in 2033), (ii) eliminating the prohibition on contributions to an IRA after age 70½ (but if an individual both contributes to an IRA and arranges for a qualified charitable distribution

(QCD) between ages 70½ and 72, the IRA contribution will reduce the portion of the QCD that would otherwise be treated as tax-free), and (most important) (iii) substantially limiting "stretch" planning for distributions from defined contribution plans and IRAs over a "designated beneficiary's" (DB's) lifetime (with several exceptions). (A DB is an individual; for example, an estate or a charity would be a non-designated beneficiary (non-DB).) Generally, much more favorable rules (allowing slower payouts) apply if a plan has DBs than if it doesn't. The SECURE Act mandates that distributions to a DB be made within 10 years following the death of the participant, with exceptions for five categories of "eligible designated beneficiaries" (EDBs). The anti-stretch provisions of the SECURE Act generally apply to owners who die after 2019.

ACTEC has filed various comments with the IRS with detailed observations and recommendations for guidance regarding the implementation of the statutory provisions. The IRS issued proposed regulations to update the minimum distribution rules, including guidance regarding the SECURE Act, on February 23, 2022. The IRS delayed the issuance of final RMD regulations until the provisions impacted by SECURE 2.0 could be revised. Notices 2023-54 and 2024-35 provided transition relief and stated that the final RMD regulations would not apply until 2025. Guidance in the form of questions and answers regarding certain provisions in SECURE 2.0 was released December 20, 2023, in Notice 2024-2, 2024-2 I.R.B. 316 (dated January 8, 2024).

The long-awaited final regulations for distributions from retirement plans and IRAs, including implementation of changes made by the SECURE Act (and some changes by the SECURE 2.0 Act) were released July 18, 2024, and published in the Federal Register on July 19, 2024. The final regulations largely follow the 2022 proposed regulations but include various clarifications and some significant changes.

b. **Further Discussion.** For more detailed discussions of planning considerations under the SECURE Act, the SECURE 2.0 Act, and the final regulations, see Item 14 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

18. Form 709 Changes for 2024 and Form 706 Changes for 2025

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

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

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

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

b. **Gift Splitting.**

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

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

confusion?)

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

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

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

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

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

The reverse QTIP election checkbox may be particularly confusing (meaning that it may often inadvertently not be checked) because it has a GST election being made under a very small column on the gift schedule rather than in Schedule D that deals with generation-skipping transfer taxes. (That election was previously made in Schedule D, Part 2, GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election.)

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

e. **Electronic Filing.** The IRS indicated in its "e-News for Tax Professionals" webpage on June 27, 2025 that Forms 709 and 709-NA may now be filed electronically.

The Form 706, United States (and Generation-Skipping Transfer) Tax Return (Rev. August 2025), for decedents dying after 2024, was posted on September 4, 2025.

- Schedules are separate documents; the Form 706 document just has Parts I-VI.
- Draft instructions say to "File Schedules A through I, as appropriate, to support the entries in Part V, items 1 through 9."
- The Schedules have universal formatting changes including multiple rows, headings for columns, additional pages for the separate schedules, and cross references to the appropriate line for inputting values from the schedule to the Recapitulation in Part V of the Form 706.
- *See* David Pratt & Ryan Chusid, *Ready to File an Estate Tax Return for a 2025 Decedent? Not So Fast, New Draft Form 706 Released by the IRS for Decedents Dying After December 31, 2024*, LEIMBERG ESTATE PLANNING NEWSLETTER #3241 (Sept. 3, 2025).

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

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

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

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

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

   The CTA requires that certain entities must disclose to the Financial Crimes Enforcement Network ("FinCEN") identifying information about the entity, individual owners and those who control the entity ("Beneficial Owners"), and "Applicants" applying to form an entity. "Beneficial Owners" are individuals who directly or indirectly exercise substantial control over the company or own or control at least 25% of the company (specified exceptions are provided).

c. **Resources.** For a much more detailed overview of highlights of the beneficial ownership reporting requirements (including the general reporting requirements and penalties for failure to comply, BOI issues for trusts, FinCEN frequently asked questions, options when owners refuse to provide information, and legislative proposals to extend the reporting dates) see Item 8 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and Item 3 of Estate Planning Current Developments and Hot Topics 2022 (December 2022) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

d. **Constitutionality of CTA.**

   (1) ***National Small Business United, d/b/a the National Small Business Association v. Yellen,* Case No. 5-22-cv-1448-LCD (N.D. Ala. March 1, 2024).** The district court held that the Corporate Transparency Act is unconstitutional "[b]ecause the CTA exceeds the Constitution's limits on the legislative branch and lacks a sufficient nexus to any enumerated power to be a necessary or proper means of achieving Congress' policy goals …" The court examines three sources proposed by the government to support the constitutional authority for Congress' enactment of the CTA: (1) the foreign affairs power, (2) the Commerce Clause authority, and (3) Congress' taxing power. The bulk of the opinion analyzes the Commerce Clause, and the focus of the analysis is on the distinction between regulating the mere formation of entities versus the regulation of entities that actually move in foreign or interstate commerce. The court expressed

the view that "Congress would have written the CTA to pass constitutional muster … [by] imposing the CTA's disclosure requirements on State entities as soon as they engaged in commerce, or … prohibiting the use of interstate commerce to launder money, 'evade taxes, hide … illicit wealth, and defraud employees and customers.'" The court did not address the plaintiff's allegations that the CTA violates the First, Fourth, Fifth, Ninth, and Tenth Amendments.

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

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

The Eleventh Circuit on Dec. 16, 2025, reversed the District Court opinion, rejecting the constitutional challenges to the CTA, remanding the case to the District Court, and lifting the court's stay on enforcement of the CTA. The Eleventh Circuit rejected the district court's conclusion that the CTA exceeds the Constitution's limits on the legislative branch, finding that "the CTA is a constitutional exercise of Congress's power under the Commerce Clause." The circuit court stated that the CTA regulates economic activity on its face, prohibiting anonymous corporate operations, regulating active commercial entities, and requiring them to disclose ownership information. The opinion also noted that the CTA has many privacy guarantees "[b]ecause the CTA's disclosure requirement is reasonable, there is no Fourth Amendment issue" (the prohibition against unreasonable search and seizure). *National Small Business United v. Dept of Treasury*, No. 24-10736 (11th Cir. Dec. 16, 2025). *See* Amanda Athanasiou, *Eleventh Circuit Rejects Constitutional Challenges to CTA*, TAX NOTES TODAY (Dec. 17, 2025).

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

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

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

As to the likelihood of success, the plaintiffs had alleged that the CTA is beyond Congress's constitutional powers and violates their rights under the First, Fourth, Ninth, and Tenth Amendments. The court concluded that the CTA is beyond Congress's enumerated powers, is not justified by the Commerce Clause or the Necessary and Proper Clause, and the plaintiffs

showed a substantial likelihood of success. (The court did not address the claims under the First and Fourth Amendments.)

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

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

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

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

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

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

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

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

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

government delayed implementation of the statute nearly four years after Congress enacted the law). *McHenry v. Texas Top Cop Shop, Inc.*, 604 U.S. __ (2025) (Docket No. 24A653 Jan. 23, 2025).

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

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

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

(3) ***Smith v. U.S. Department of the Treasury* (E.D. Tex. Jan. 20, 2025 and Feb. 18, 2025).** The U.S. District Court for the Eastern District of Texas on January 7, 2025, in a lengthy Memorandum Opinion addressed plaintiff's motion for a preliminary injunction against enforcement of the CTA. It considered the likelihood of success on the merits, the risk of irreparable harm, and the balance of the equities and the public interest. The court granted a preliminary injunction against enforcement of the CTA, but it applied the injunction as to enforcement of the statute (31 U.S.C. §5336) only as to the named plaintiffs in the case. However, it granted a nationwide injunction against enforcement of the BOI Reporting Rule in the final regulations. *Smith v. U.S. Department of the Treasury*, Memorandum Opinion and Order Granting Motion for Preliminary Relief, No. 6:24-cv-336 (E.D. Texas Jan. 7, 2025). About a month later, the district court stayed its nationwide injunction in an order signed Feb. 17, 2025, and entered on Feb. 18, 2025, in light of the Supreme Court's order in the *Texas Top Cop Shop, Inc.* case.

(4) ***Small Business Association of Michigan v. Bessent* (W.D. Mich. Mar. 3, 2025).** The U.S. District Court for the Western District of Michigan on March 3 granted plaintiffs'' motion of summary, enjoining enforcement of the CTA's reporting requirements against the plaintiffs, two organizations, three individual companies, and two individual beneficial owners. Unlike prior cases that have found the CTA to be unconstitutional under the Commerce Clause or because it exceeded Congress's power, the court found that the CTA violated the plaintiffs' Fourth Amendment rights against unreasonable search. The court noted that

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

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

The court noted the FinCEN announcement on March 2, 2025, that it would not enforce the CTA against domestic companies, but reasoned that did not moot the plaintiffs' case because that announcement did not carry the force of law. *Small Business Association of Michigan v. Bessent*, No. 1:24-cv-00314 (W.D. Mich Mar. 3, 2025). The Treasury Department filed a notice of appeal on May 1, 2025. The appeal will be heard by the Sixth Circuit.)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) ***Firestone v. Bessent* (D. Ore. Sept. 20, 2024).** A federal district court in Oregon on September 20, 2024, refused to grant a preliminary injunction against the enforcement of the CTA, finding that the plaintiffs failed to demonstrate a likelihood of success on the merits (that the Act is unconstitutional), irreparable injury, or that the balance of hardships tipped in their favor. *Firestone v. Yellen*, No. 3:24-cv-1034-SI (D. Ore. Sept. 20, 2024). The court addressed claims that the Act exceeded Congress's constitutional authority and claims of unconstitutionality under the First, Fourth, Fifth, Eighth, Ninth, and Tenth Amendments, and that the statute is unconstitutionally vague. The Ninth Circuit approved the government's motion to hold the proceedings in abeyance until a new rule regarding reporting requirements is finalized, despite the plaintiff's objection to that motion. *See* Amanda Athanasiou, *CTA Constitutional Challenge Stayed in Ninth Circuit*, 187 TAX NOTES FEDERAL 943 (May 5, 2025).

(b) ***Community Associations Inst. v. US Department of the Treasury* (E.D. Va., Oct. 24, 2024)**. A preliminary injunction was also denied on October 24, 2024, by a federal district court in Virginia. The court concluded that the plaintiffs were unlikely to prevail in contesting the constitutionality of the CTA under the Commerce Clause and under the First Amendment or that the FinCEN rules implementing the CTA failed to comply with the Administrative Procedure Act's notice-and-comment requirements. *Community Associations Inst. v. Yellen*, No. 24-cv-1597 (E.D. Va., Oct. 24, 2024). The government filed a motion May 6, 2025, to hold the proceedings in abeyance until a new rule regarding reporting requirements is finalized, the plaintiffs did not object, and the Fourth Circuit Court of Appeals granted the abeyance on May 6, 2025. *See* Amanda Athanasiou, *Second CTA Constitutional Challenge Paused in Circuit Court*, 187 TAX NOTES FEDERAL 1109 (May 12, 2025); *Government Requests Pause in CTA Litigation Pending New Rule*, TAX NOTES TODAY FEDERAL (April 23, 2025).

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

(7) **Other Cases.** At least three additional cases have been filed in federal courts challenging the constitutionality of the CTA. *Gargasz v. Yellen*, No. 23-cv-02468 (N.D. Ohio Dec. 29, 2023) (arguing invalidity of CTA and its regulations under the Constitution, the Paperwork Reduction Act, and the Administrative Procedure Act and seeking a nationwide injunction); *Black Economic Council of Massachusetts, Inc. v. Yellen*, No. 1:24-cv-11411 (D. Mass. May 29, 2024) (Fourth Amendment rights of beneficial owners and applicants; outside of enumerated powers; First Amendment right to associate; Fifth and Ninth Amendment claims; seeks nationwide injunctive relief; the court granted an Order May 13, 2025, granting the Treasury's request to hold the suit in abeyance until new regulations are finalized);*Taylor v. Yellen*, No. 2:24-cv-00527 (D.C. Utah July 29, 2024) (First Amendment, Fourth Amendment, Due Process, Congress exceeded authority, right to associate; plaintiffs withdrew motion for preliminary injunction following FinCEN announcement that it would not enforce the CTA against domestic companies).

In some of the cases, the government has requested a pause in the proceedings until a new rule regarding the act's reporting requirement is finalized, observing that the rule may cause the case to become moot.

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

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

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

g. **Residential Real Estate Non-Financed Transfers; Residential Real Estate Reporting Delayed Until March 1, 2026.** Real estate "all-cash" sales in certain geographic areas must currently be reported under the existing Real Estate Geographic Targeting Order program (GTO) under the Bank Secrecy Act. Regulated lenders are excluded because banks already have anti-money laundering (AML) programs and requirements of filing suspicious activity reports (SARs) under the Bank Secrecy Act.

FinCEN on February 7, 2024, filed a Notice of Proposed Rulemaking (RIN: 1506-AB54) generally requiring that non-financed residential real estate transfers to trusts or entities be reported to FinCEN. Final rules were issued on August 28, 2024 (and published in the Federal Register on August 29, 2024) (RIN: 1506-AB58). FinCEN received 621 comments, and the preamble to the final rules responds to those comments. The rules are effective December 1, 2025. However, but FinCEN released an announcement on September 30, 2025, stating that the reporting requirements for residential real estate are delayed until March 1, 2026, "to provide industry with more time to comply—consistent with the Administration's agenda to reduce compliance burden."

(1) **Purpose.** The purpose of these reporting requirements is to combat and deter money laundering through non-financed residential real estate transfers, because non-financed transfers of

residential real estate are subject to less oversight from financial institutions than financed transfers.

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

The reporting requirement applies regardless of the size of the sales transaction (including for gift transactions) as long as the transaction is a non-financed transfer. The preamble to the final rules reasons that "[l]ow value non-financed transfers to legal entities and trusts, including gratuitous ones for no consideration, can present illicit finance risks and are therefore of interest to law enforcement." As discussed immediately 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. A non-financed transfer is one that is not financed "by a financial institution that has both an obligation to maintain an anti-money laundering program and an obligation to report suspicious transactions."

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

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

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

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

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

Sales to trusts would not be excepted from the reporting requirements under this exception for gifts to trusts (unless the sale is financed by a financial institution rather than being financed by the trust itself).

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

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

Over the last decade, bar groups and ACTEC have fought against a requirement that attorneys must file "suspicious activity reports" on their clients (without notice to their clients), **but that may come at some point.** The "Establishing New Authorities for Business Laundering and Enabling Risks to Security Act," or ENABLERS Act, would expand the list of "gatekeepers" who are required under

the Bank Secrecy Act to conduct due diligence on clients and file suspicious activity reports, and the expanded list would include attorneys who assist in the following transactions: "the formation or registration of a corporation, limited liability company, trust, foundation, limited liability partnership, or other similar entity" or the "acquisition or disposition of an interest" in one of those entities.

The ENABLERS Act passed the House of Representatives as part of the National Defense Authorization Act of 2023 on July 14, 2022, with broad bipartisan support, but the U.S. Senate voted against including the Act in the 2023 defense budget on December 7, 2022. Similar legislation was not introduced in 2023, 2024, or 2025.

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

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

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

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

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

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

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

The court did not address whether a different result would occur if the trust termination and sale were part of an integrated transaction (the court noted that the IRS did not argue that the "substance over form" doctrine applied) (see Opinion at 25). Also, in footnote 18 the court expresses no view on whether H's sons made a gift by consenting to the termination and distribution to W of all trust assets. (That issue is addressed in *McDougall v. Commissioner* 163 T.C. No. 5 (Sept. 17, 2024), discussed in Item 21 below, the same case in which the IRS had expressed its litigating position in CCA 202118008.) In addition, footnote 3 clarifies that because the court determined that no gifts resulted under §2519, the court did not have to address whether adequate disclosure had been made on the 2012 gift tax return such that the assessment of additional gift tax was barred by limitations.

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

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

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

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

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

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

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

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

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

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

d. **Court Analysis of Section 2519 Issues.** For a detailed discussion of the court's analysis of §2519 issues raised in Anenberg, see Item 27.d of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (Dec. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

e. **Observations.**

(1) **Major Blow to IRS Attacks Under §2519.** Ever since the Tax Court's decision in *Kite v. Commissioner* over ten years ago, the IRS has increasingly been making §2519 attacks on planning involving existing QTIP trusts. The holdings and reasoning in the unanimous reviewed Tax Court opinion in *Anenberg*, delivered merely **three months** after the hearing on the motions for partial summary judgment, are a major blow to §2519 arguments the IRS has been making. If all the QTIP trust assets are distributed to the spouse-beneficiary, who later engages in transfer planning transactions, §2519 will not result in a deemed gift of the remainder interest subject to gift tax (at least if the termination/distribution/ transfer transactions are not part of an integrated plan under the substance over form doctrine – more about that in Item 20.e(3) below). The court's focus on the "QTIP regime," the tax fiction treating the spouse as owning the QTIP trust assets, and the key policy of deferring transfer taxation until the surviving spouse's subsequent death (or gifts) but avoiding a resulting double taxation may be the guidepost for future decisions.

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

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

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

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

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

Observe, that conclusion appears to be a repudiation of *Kite II*, which refused to allow any offset in the determining amount of gift resulting from a §2519 transfer for amounts received by the spouse in a transfer that triggers §2519. See Item 20.e(5) below.

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

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

On the other hand, if a QTIP trust termination and *gift* of assets are treated as an integrated transaction, a gratuitous transfer would occur and some taxable gift may result under §2519. However, the gift may result only as to the gifted assets, and not the full remainder value of the trust, because the spouse would still own the remaining QTIP trust assets that had been distributed to her following the QTIP trust termination. Those assets will be subject to transfer tax when the spouse subsequently dies or makes a gift of the assets, and the underlying premise of the QTIP regime and purpose of assuring that the QTIP trust assets will eventually be subject to a transfer tax would be served without imposing gift tax on the entire remainder interest under §2519 at the time of a gift of some portion of the assets in connection with the trust termination. That goes to the issue of whether *Anenberg* repudiates *Kite II* (as discussed in Item 20.e(5) below). Treating the full remainder interest value as a taxable gift currently and subjecting the remaining assets to a transfer tax at death or upon a later gift would result in double taxation of that value. The court's summary in *Anenberg* suggests that double taxation would not be appropriate.

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

Opinion at 28 (emphasis added).

(4) **Gift by Remainder Beneficiaries Who Consent to All QTIP Assets Being Distributed to Spouse-Beneficiary; CCA 202128008; *McDougall v. Commissioner*.** A significant risk exists that the remainder beneficiaries may be treated as making a taxable gift to the spouse by consenting to the spouse receiving all the trust assets rather than just the actuarial value of her lifetime income interest. The IRS took the position in CCA 202128008 that trust remaindermen made a gift when they consented to the surviving husband receiving all the QTIP trust assets in a

nonjudicial settlement agreement terminating the QTIP trust. For a detailed discussion (and strong criticism) of CCA 202118008, see Item 8.h of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. The cases connected with that CCA are addressed in *McDougall v. Commissioner*, 163 T.C. No. 5 (Sept. 17, 2024), discussed in Item 21 below.

(5) **Impact of Kite v. Commissioner.** For a summary and discussion of Kite I and Kite II, see Item 27.e.5 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (Dec. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(6) **Income Tax Consequences.** *Estate of Anenberg* does not discuss the income tax consequences of the judicial termination of the QTIP trusts (presumably, the IRS did not raise the issue). See Item 21.f(5) below.

(7) **Planning Regarding Spouse's Interest in QTIP Trusts.** For a discussion of QTIP trust planning alternatives, see Item 21.f(4) below.

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

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

Five years after the trust was created, H, as current beneficiary and trustee, and his two children ("Children") as remainder beneficiaries, and virtual representatives of the contingent remainder beneficiaries, entered into an agreement to have all the trust property distributed to H. On the same day, H transferred "substantially all" the trust assets to trusts for the Children and their descendants in return for secured promissory notes.

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

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

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

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

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

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

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

All the gift issues have been resolved regarding H, and a final order and decision for his case was entered January 30, 2025. (Taxpayers resided in Washington, so an appeal would have been heard by the Ninth Circuit Court of Appeals, but the IRS did not file a timely notice of appeal.)

The case was remanded to the trial court (Judge Halpern as the trial judge) to determine the value of the Children's gifts. (T.C. Docket Nos. 2459-22 & 2460-22) The trial court entered an Order on April 25, 2025, concluding that the value of the Children's gifts "equaled the value of the distributions to which they would have been entitled under section 12.8 of [the predeceased wife's] will upon the termination of the Residuary Trust had they not agreed in section 2 of the Nonjudicial Agreement that all of the trust property be distributed to [H]." The court left open the effect of H's testamentary power of appointment, but stated that "because the termination of the Residuary Trust extinguished the testamentary power of appointment granted to [H] …, it is not clear that the power of appointment would have affected the value of [the Children's] interests in the Residuary Trust … to determine the distribution to which [the Children] would have been entitled upon the termination of the trust."

A one and a half day trial was held on June 16-17, 2025. Simultaneous briefs were filed by the taxpayers and the IRS on October 1, 2025.

- The children's position is that the interest to be valued was a contingent remainder interest in the trust as it existed immediately before signing the settlement agreement. At that time, the value was affected by various contingencies, including H's testamentary power of appointment to appoint assets to W's descendants, H's power as trustee to make discretionary principal distributions to himself under a prescribed standard, and the right to recover any federal or state gift or estate taxes owed by him attributable to the trust. Because of those contingencies, the remainder interests were "restricted beneficial interests" that could not be valued under the §7520 actuarial regulations, and each child's gift was valued at $156,000 under the hypothetical willing buyer/willing seller standard.

- The IRS's position is that the children could not transfer their remainder interests because of the trust's spendthrift provision, so the transfers to H could be made only be terminating the QTIP trust. The trust provided that upon termination, "each beneficiary would have a right to receive assets of a value equal to the value of their respective interests in the Trust as of the time of distribution." The IRS maintains that the children's gifts were the right to receive terminating distributions equal to the value of their actuarial interests; after executing the settlement agreement, no contingencies remained, so the gift values must be determined under the §7520 tables (each child's gift was valued by the IRS at $35.1 million to $53.4 million).

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

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

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

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

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

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

c. **Majority Opinion Analysis.**

(1) **No Gift of the Remainder Interest by H Under Section 2519; Analysis Relying on *Estate of Anenberg*.** The majority opinion summarized "lessons from *Estate of Anenberg*." *Estate of Anenberg v. Commissioner*, 162 T.C. No. 9 (May 20, 2024), addressed similar facts. It reasoned that the court did not need to decide if the spouse-beneficiary made a disposition of any part of the qualifying income interest that triggered a deemed transfer of the remainder interest under §2519. Even if it did, that only resulted in a deemed "transfer" of the remainder interest, but no

gift resulted because the surviving spouse ended up actually owning all the assets unencumbered. "At the end of the day, she gave away nothing of value as a result of the deemed transfer." *Estate of Anenberg v. Commissioner*, slip op. at 15.

The IRS in *McDougall* maintained that H made a deemed gift of the remainder interest under §2519(a) arguments: (1) because of "the implementation of the Nonjudicial Agreement"; or (2) by "the implementation of the Nonjudicial Agreement coupled with the subsequent sale of the trust property for promissory notes." The court rejected the IRS's position. Footnote 5 of the majority opinion in *McDougall* stated (similar to *Estate of Anenberg*) that the court did not decide whether a disposition of H's qualifying income interest occurred that triggered §2519. Even if it did, no gift of the remainder interest resulted "for the reasons we set out in Estate of Anenberg." *McDougall v. Commissioner*, slip op. at 11.

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

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

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

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

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

(3) **Value of Children's Gifts.** The court will determine the value of the Children's gifts to H in a later proceeding. *Id.* at 12, n.7. The trustee could make discretionary principal distributions to H, and H held a testamentary power of appointment to appoint trust assets to the wife's descendants. The court specifically observed that "under the terms of [the wife's] will, [H] could have decided in his own will to reduce one of the children's shares significantly," *id.* at 15-16, and added in a footnote that "[t]he import (if any) of these terms for the value of [the Children's] remainder rights remains to be decided." *Id.* at 16, n.10. (Because the valuation issue is still

pending regarding gifts by the children, there is no final judgment, and periods to appeal the children's cases are not running.)

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

(1) **Adequate Consideration vs. Incomplete Transfer Rationale.** *Estate of Anenberg* discussed two alternate approaches for its conclusion that the surviving spouse did not make a gift of the remainder interest under §2519: (1) the spouse received adequate consideration offsetting the value of a deemed transfer of the remainder interest; or (2) the spouse's deemed transfer under §2519 resulted in an incomplete gift. The *Estate of Anenberg* opinion relied primarily on the adequate consideration rationale.

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

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

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

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

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

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

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

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

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

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

c. **April 25, 2025 Order.** On remand to the trial court (with Judge Halpern as the trial judge) to determine the value of the Children's gifts, the court entered an order (the "Order) on April 25, 2025, in response the IRS's motion for partial summary judgment seeking a ruling that each donor transferred his or her "right to receive outright and free of trust a one-half share of the Residuary Trust assets allocable to the remainder interest, as opposed to a one-half share of the remainder interest itself." The Order concluded:

> For now, we conclude only that the value of the gifts Linda and Peter made to Bruce equaled the value of the distributions to which they would have been entitled under section 12.8 of Clotilde's will upon the termination of the Residuary Trust had they not agreed in section 2 of the Nonjudicial Agreement that all of the trust property be distributed to Bruce.

Section 12.8 of the wife's will allowed the trustee to make either pro rata or non-pro rata distributions "so long as the distributees receive assets of a value equal to the value of their respective interest[s] in the trust at the time of distribution."

The Order discussed the effect of the H's testamentary limited power of appointment on the value of the Children's gifts.

> In *McDougall*, 163 T.C., slip op. at 16, n.7, we explicitly left open "[t]he import (if any) of [Bruce's testamentary power of appointment] for the value of Linda's and Peter's remainder rights." Disposing of respondent's Motion does not require us to answer at this time the question we left open in our prior Opinion. Bruce's testamentary power of appointment and other contingencies that might have affected what Linda and Peter would have received from the Residuary Trust upon Bruce's death had the trust not been terminated earlier may or may not have affected the value of Linda's and Peter's interests in the trust. But the impact of those contingencies does not turn on whether we view the property Linda and Peter transferred to Bruce as rights to distributions or instead as remainder interests. [The court noted in a footnote: Respondent argues that, in either event, the contingencies that existed before the termination of the Residuary Trust did not affect the value of the gifts in issue because the termination of the trust eliminated those contingencies.]

…

A contingency that might have affected the value of Linda's and Peter's interests in the Residuary Trust while the trust remained in existence would not necessarily have been relevant in determining the value of those interests for purposes of section 12.8 of Clotilde's will if the termination of the trust eliminated the contingencies. In particular, because the termination of the Residuary Trust extinguished the testamentary power of appointment granted to Bruce by section 5.3 of Clotilde's will, it is not clear that the power of appointment would have affected the value of Linda's and Peter's interests in the Residuary Trust for the purpose of applying section 12.8 of that will to determine the distributions to which Linda and Peter would have been entitled upon the termination of the trust. Again, that question remains open.

The Order states that the issue of the effect of the testamentary limited power of appointment on the value of the gift "remains open," but the Order says "it is not clear that the power of appointment would have affected the value of [the Children's] interests," and the conclusion in the Order seems the ignore the effect of the power of appointment.

d. **Trial**, A one and a half day trial was held June 16-17, 2025, in Seattle, Washington.

e. **Post-Trial Simultaneous Briefs.** The taxpayers and the IRS both filed Simultaneous Opening Briefs on October 1, 2025.

(1) **Taxpayers' Brief.** Some of the points made in the taxpayers' brief include the following.

- Taxpayers again asserted their objection to the Order "as (i) [the Children] made no gifts because [H] is deemed to own all property of the Residuary Trust; and (ii) [the Children], as contingent beneficiaries of the Residuary Trust whose interests were subject to defeasance, never had any right to receive ***outright and free of trust*** any property of the Residuary Trust, either before or after the Residuary Trust was terminated by the NJA. Thus, the Order erroneously assumes and requires valuation of immediate rights to receive property that never existed." (emphasis in original)
- Property transferred must first be determined under state law before the value of rights associated with the property can be determined. A donor may transfer no more than what he or she owns.
- The §7520 actuarial valuation tables do not apply because the remainder interests are "restricted beneficial interests," which include a remainder interest "that is subject to any contingency, power, or other restriction. … In general, a standard section 7520 annuity, income, or remainder factor may not be used to value a restricted beneficial interest." Reg. §25.7520-3(b)(1)(ii).
- Section 7520 should not be applied if "the result is so unrealistic and unreasonable that either some modification in the prescribed method should be made, or complete departure from the method should be taken, and a more reasonable and realistic means of determining value is available" (quoting *RERI Holdings*, 143 T.C. at 65). The IRS asserts that the Children made gifts of assets that H is deemed to own under the QTIP rules, meaning H is both the owner and donee of the same assets at the same time. That theory is an end run around the purpose of §§2044 and 2519 and attempts "to subject the McDougall family to transfer tax on the same assets at least twice: (1) the moment of the NJA and (2) upon [H]'s death."
- Actual fair market value must be determined on the basis of all facts and circumstances without regard to §7520 when the standard table factors cannot be used. Under the hypothetical willing buyer/willing seller standard, hypothetical buyers aware that H had signed a will exercising the power of appointment to appoint the assets away from the holders of the remainder interests "would know that the acquisition of the contingent remainder interest in the Residuary Trust would entitle them to ***nothing*** unless they were able to convince [H] to both revoke the exercise of his limited power of appointment ***and*** never re-exercise that power. (emphasis in original)
- Because the §7520 actuarial tables do not apply, factors to determine the fair market value of the remainder interests "we must consider the relevant facts of which the hypothetical willing buyer is presumed to have reasonable knowledge, namely (i) [H]'s right to all income;

(ii) [H]'s ability to invade principal for his health, maintenance, and support; (iii) [H]'s exercise of his power of appointment; and (iv) [H]'s right of recovery of gift tax under § 2207A."

- "Because of [H]'s exercise of his power of appointment, the fair market value of the Remainder Interests (particularly to a hypothetical willing buyer or seller) was nominal on the Valuation Date."
- David Eckstein's (Management Planning, Inc.) valuation of the Remainder Interests, under the application of these facts in three different scenarios, was summarized in the brief. The last scenario, took into consideration all of these factors, including the existence of the testamentary power of appointment.

> Mr. Eckstein reasonably viewed the likelihood of Bruce unwinding the exercise of his limited power of appointment as analogous to discovering a Van Gogh at a garage sale or buying what ends up being a winning lottery ticket: "any value attributable to the Remainder Interests would be based on the speculative potential that Bruce would revoke his current exercise of the LPOA prior to his death." (Ex. 67-J, p. 10; Tr. 71:18-72:6.)
>
> Said more simply, if Bruce had died on the Valuation Date immediately prior to the execution of the NJA, the holder of a Remainder Interest would receive nothing. Similarly, if the holders of the Remainder Interests had sold their remainder interests immediately prior to the execution of the NJA, the buyer would have purchased the "speculative potential that Bruce would revoke his current exercise of the LPOA prior to his death" – and if the buyer was unable to convince Bruce to revoke that exercise, the buyer would be left with nothing.
>
> To quantify the significant risks associated with investing in one of the Remainder Interests, Mr. Eckstein considered "a variety of market data, focusing on highly speculative assets….

- Mr. Eckstein determined the value of each of the Children's Remainder Interests to be about $50,000, adjusted to $156,000 after allocation of the §2207A reimbursement right.
- The IRS used two experts, The IRS's first expert stated that he did not assume the interest was being bought be a hypothetical third party but looked at the value associated with these interests to the Children; therefore he did not apply the fair market value standard required by Reg. §25.2512-1 and his testimony should be disregarded. He failed to consider risk factors associated with uncertain levels of future distributions, disregarded the implications of the power of appointment, did not account for the greater risk associated with investing in a remainder interest relative to an income interest, disregarded lack of control and lack or marketability discounts, and did not consider H's right to determine what constitutes principal and income, He determined the value of each of the Children's Remainder Interests was $49,197,850, adjusted to $35,142,024 after considering H's §2207A reimbursement right.
- The IRS's second expert was a Washington attorney who administers trusts and is not a valuation professional. He determined the value of the Remainder Interests under the §7520 actuarial tables. He valued each of the Children's Remainder Interests at $53,636,426, adjusted to $38,312,499 after considering H's §2207A reimbursement right.

(2) **IRS's Brief.** The IRS's brief takes the position that the §7520 tables can be used. H maintained a relatively modest standard of living and has never required principal distributions from the trust. The possibility of his exercise of his right to principal distributions is so remote as to be negligible to have any influence over valuation under the §7520 tables.

The existence of the testamentary power of appointment does not preclude valuation under §7520. If the Children's interests were valued the day before the nonjudicial agreement, they would be restricted beneficial interests because of the contingency of the power of appointment. However, they must be valued taking into consideration transformations brought about by the nonjudicial agreement, which terminated the Residuary Trust making the power of appointment inoperative.

> If Linda's and Peter's remainder interest were valued on October 30, 2016 (the day prior to execution of the Nonjudicial Agreement), those values simply could not be determined under the § 7520 tables. On that day, Linda's and Peter's remainder interests were subject to Bruce's LPOA, causing those trust interests to be

> 'restricted beneficial interest' valued instead under the "willing buyer, willing seller" standard. See Treas. Reg. § 25.7520-3(b)(1)(ii).
>
> In these cases, however, Linda's and Peter's remainder interest are valued as of October 31, 2016 and must take into account transformations brought about by the instrument of transfer (the Nonjudicial Agreement). ... The instrument of transfer (the Nonjudicial Agreement) resulted in pre-distribution changes that affected the value of Linda's and Peter's remainder interests – it terminated the Residuary Trust, rendered Bruce's LPOA inoperative, and made the Spendthrift Clause nonbinding. In sum, the instrument of transfer (the Nonjudicial Agreement) removed all restrictions on the beneficiary's trust interests that may have been imposed by Clotilde's Will, including Bruce's LPOA and transformed [the Children]'s remainder interests from 'restricted beneficial interests' to 'ordinary remainder interests' susceptible to valuation under the § 7520 tables.

In addition, a restriction can be ignored if its exercise is so remote as to be negligible. Taxpayers have the burden to show there is more than a remote possibility that H would appoint the assets away from the Children. Under the W's will, the Children would have received the Residuary Trust assets outright following H's death. Under the exercise of H's power of appointment, he left the assets to trusts for the Children, but the trust "afforded [the Children] almost identical rights entitling them to withdraw nearly the entire corpus…."

f. **Observations.**

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

Estate of Anenberg and *McDougall* make clear that those attacks under §2519 will be unsuccessful in situations where all QTIP assets are distributed to the spouse-beneficiary. The key to the §2519 analysis in both cases is that assets passing to the spouse-beneficiary can be applied to offset deemed transfers of the remainder interest under §2519, repudiating the result in *Kite II*. (*Kite I* and *Kite II* are discussed in Item 20.e(5) above.) *McDougall,* however, indicates that gift issues may arise for remainder beneficiaries when QTIP trusts are terminated early with the consent of the remainder beneficiaries.

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

(3) **Step Transaction Analysis.** *Estate of Anenberg* did not address whether the combination of the distribution of all QTIP assets to the spouse followed by the sale of the assets would trigger §2519. That seemed to be the general approach of *Kite I* (finding that the combination of the distribution of all assets to the surviving wife followed by her sale of the assets for a deferred private annuity triggered §2519). The IRS did not make that step transaction argument in *Estate of Anenberg*, but it did in *McDougall*, and the court rejected the argument. Combining an early termination of QTIP assets distributed entirely to the spouse with even an immediate sale of the

assets by the spouse is safe from a step transaction attack under §2519 in the Tax Court because of *McDougall*.

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

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

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

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

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

ii. **Improperly Distributed Asset Treated as Still in Trust.** The IRS may take the position that the improperly distributed assets should be treated as if they were still in the trust. *See Estate of Lillian Halpern v. Commissioner*, T.C. Memo. 1995-352 (distributions from general power of appointment marital trust to descendants; spouse consented but the distributions were not authorized; court recognized the distributions that were made when the spouse was competent but did not recognize distributions made after the spouse had become incompetent because a guardian could have set aside the distributions, so those distributions were included in the spouse's estate under §2041); *Estate of Hurford v. Commissioner*, T.C. Memo. 2008-278 (beneficiary-trustee made distribution to self, contrary to standards in trust, and sold those assets for private annuity; trust assets included in decedent's gross estate under §2036 and the distributed assets were not excluded from the decedent's gross estate merely because of ascertainable standards in the trust); *Estate of Hartzell v. Commissioner*, T.C. Memo. 1994-576 (court rejected IRS argument that assets distributed from marital trust to decedent during her lifetime and given to family were includable in her gross estate because the distributions were improper transfers from the trust; Ohio court would have approved the transfers because distribution standard of "comfort, maintenance, support, and general well-being" would include distributions to assist her desire to continue giving gifts to family members to ensure family control of family businesses); *Estate of Council v. Commissioner*, 65 T.C. 594 (1975) (IRS argued that trustee did not have the authority to distribute trust assets to spouse for gifting purposes; court stated that the issue was not whether a state court would have approved the distributions beforehand but whether a

state court would rescind the distributions after made; conclusion that trustees acted within the bounds of reasonable judgment); *cf. United Food & Commercial Workers Unions v. Magruder Holdings, Inc.*, Case No. GJH-16-2903 (S.D. Md. Mar. 27, 2019) (failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes); *SEC v. Wyly,* 2014 WL 4792229 (S.D.N.Y. Sept. 25, 2014) (SEC recoupment case; court reasoned that a failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes).

(c) **Additional Transfers to Spouse.** If the goal is to get more assets to the spouse than can be justified under the distribution standards, trust modification actions may be considered to get assets to the spouse-beneficiary. This could be a traditional commutation (with the spouse receiving the actuarial value of his or her interest in the trust) or be a complete distribution of trust assets to the spouse in an early termination (as was done in *Estate of Anenberg* and *McDougall*). (Beware that early terminations of trusts can have disastrous income tax consequences, as discussed in Item 21.f(5) below.)

i. **Traditional Commutation.** A traditional commutation would not be covered by the rationale of the Tax Court in the *Estate of Anenberg* and *McDougall* cases and would result in the spouse being treated as making a gift of the full remainder interest in the trust under §2519. See Item 21.f(2) above.

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

iii. **Decanting.** Using decanting rather than judicial termination or nonjudicial settlement agreement to transfer assets to the spouse (perhaps by adopting a broad distribution standard) may avoid having explicit consent from remainder beneficiaries, but there are fiduciary concerns and the IRS took the position in CCA 202352018 that failing to object would result in a gift, the same as with consent. See Item 21.f(4)(b)i above. But at least that approach may avoid direct consent by the remainder beneficiaries.

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

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

(d) **Disclaimer by Spouse.** Another way for the spouse to make a transfer of assets in the QTIP trust, so they will not be in the spouse's gross estate, would be to make a disclaimer of the spouse's interest in the QTIP trust. If the disclaimer is a qualified disclaimer, the transfer of assets to the QTIP trust will not qualify for the marital deduction, so a transfer tax would be owed by the donor or decedent who created the QTIP trust. If the disclaimer is not a qualified disclaimer, the spouse would be treated as giving the income interest, which would trigger a deemed transfer of the remainder interest under §2519. See Letter Rulings 202504006-202504007 (non-qualified disclaimer by spouse of one of two QTIP trusts following severance, non pro rata severance did not cause gain recognition because trust agreement permitted trustee to make non pro rata division between trusts, disclaimer of all income interest of trust 1 will not cause a gift of trust 2, trust 1 will not be included in taxpayer's gross estate, disclaimer will not cause interest in trust 2 to be valued at zero under §2702).

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

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

If assets are moved into the hands of the spouse-beneficiary by the exercise of a power of appointment, that should avoid the possibility of the IRS arguing that the transaction should be treated as a gift from the remainder beneficiaries to the spouse-beneficiary or as a purchase of the spouse-beneficiary's interest by the remainder beneficiaries, resulting in a gain recognition transaction (discussed in Item 21.f(5) below).

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

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

(h) **Resources.** Be forewarned that planning with large QTIP trusts is difficult. *See* Joy Miyasaki & Read Moore, *Estate Planning Strategies for QTIP Trusts: Do Good Things Come to Those Who Defer?*, AMERICAN COLLEGE OF TRUST & ESTATE COUNSEL 2023 ANNUAL MEETING (Mar. 2023); Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 12, ¶1202.3 (2010). For a discussion of other planning alternatives (including planning for distributions to the spouse, and the risks of unauthorized distributions, so the spouse can make estate planning gifts and transfers of those assets), see Item 9.h of Estate Planning Current Developments and Hot Topics 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. *See also* Richard S. Franklin, *Lifetime QTIPs—Why They Should Be Ubiquitous in Estate Planning*, 50th HECKERLING INST. ON EST. PL. ch. 16 (2016); Richard S. Franklin & George Karibjanian, *The Lifetime QTIP Trust – the Perfect (Best) Approach to Using Your Spouse's New Applicable Exclusion Amount and GST Exemption*, 44 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. 1 (Mar. 14, 2019).

(5) **Income Tax Consequences.** Apparently, the IRS did not take the position in either *Estate of Anenberg* or *McDougall* that the early termination of the QTIP trust resulted in an income taxable transaction between the income and remainder beneficiaries. However, that is not totally clear in *McDougall*.

The potential income tax consequences of the transactions described in the NJA are still an open question. On December 26, 2024, Halpern entered an order that there was "no deficiency or penalties in income tax due from [SS] for the taxable year" of the commutation. However, he vacated that order on January 30, 2025, in response to a motion to vacate filed by the IRS. It is unclear at this point whether the IRS is pursuing an income tax deficiency in this case against either SS or C (or whether it could if it wanted to).

Kerry Ryan, *Checking In on Checking Out of the QTIP Regime*, 189 TAX NOTES FEDERAL 639 (Oct. 27, 2025) (footnotes omitted).

The IRS views the early termination of trusts as income tax events. The remainder beneficiaries in Letter Rulings 202509010 (discussed in Item 39 below) and 201932001-201932010 were treated as having purchased the interests of the life beneficiary and the contingent remainder beneficiaries (and the life beneficiary had a zero basis in his interest under the uniform basis rules of §1001(e) so the total amount paid to the life beneficiary was capital gain). (The taxpayers requested those rulings – presumably following discussions with the IRS that the early termination would be treated as a recognition event and to obtain rulings that the income recognition would be long-term capital gain.) The remainder beneficiaries, as the deemed purchasers, do not pay tax on amounts **received** in the commutation (as the fictional purchasers, they are just receiving what is left in the trust after they have bought out everyone else), but they "realize gain or loss on the property exchanged." So, they recognize gain on the assets **paid out** to others less the amount of their uniform basis attributable to those assets. Massive income taxation can result, which could be totally avoided by not terminating the trust early. For a detailed discussion of the 2019 letter rulings and the income tax effects of early terminations of trusts, see Item 16 of Estate Planning Current Developments and Hot Topics (December 2020) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

If the IRS were to take this position in *McDougall*, an interesting question is whether the value of the trust interests for gift tax purposes would be same as for income tax purposes. The children might prefer a high value of H's interest for gift tax purposes (to reduce the value of their remainder interest) but a low value for income tax purposes (because the children might be treated as using appreciated assets to purchase H's income interest).

> Would the value of the trust interests finally determined for gift tax purposes also apply to any alleged income tax consequences of the termination? This could create a whipsaw for C [the children] because C's incentives on the question of valuation as between income and gift tax may be opposed to each other. For income tax purposes, C would prefer a low valuation for SS's [H's] income interest (since that is the measure of C's potential amount realized), whereas C would prefer a high value assigned to SS's income interest for gift tax purposes since that would result in a concomitantly low value assigned to C's gifted remainder interest.

Kerry Ryan, *Checking In on Checking Out of the QTIP Regime*, 189 TAX NOTES FEDERAL 639 (Oct. 27, 2025) (footnote omitted).

What the effect would be when the full trust value is paid to the income beneficiary of a QTIP trust is not clear. It would be strange to treat the remainder beneficiary as having purchased the interest of the life beneficiary when the remainder beneficiary ends up with nothing. At least for income tax purposes, the remainder beneficiary may be treated as making a gift to the income beneficiary of the value of the remainder interest, which amount therefore would not be taxable income under §102(a). *See Commissioner v. Duberstein*, 363 U.S. 278, 284-286 (1960) ("detached and disinterested generosity"). Perhaps any deemed purchase by the remainder beneficiary would be limited to the value of the income interest. (Another way of reaching that conclusion is to treat the transaction first as a commutation of the actuarial interests, and second as a transfer from the children to H of their remainder interest value. The commutation could have income tax effect, but the transfer of the remainder interest would be an income tax-free gift.)

Prior to the Tax Court's decision in *McDougall*, it is conceivable that the remainder interest might have been treated as a gift for income tax purposes (and therefore not taxable income to the income beneficiary under §102) but not a gift for transfer tax purposes (because for transfer tax purposes the spouse is treated as the owner of the full value of the QTIP assets under the legal fiction created in the QTIP regime); however, *McDougall* rejected that analysis for transfer tax purposes.

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

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

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

22. Overruling of *Chevron* Doctrine Regarding the Validity of Regulations, *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (June 28, 2024) , and Subsequent Cases, *Bondi v. VanDerStok*, 604 U.S. __ (March 26, 2025); *Federal Communications Commission v. Consumers' Research*, 606 U.S. __ (June 27, 2025)

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

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

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

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

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

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

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

The majority decision concluded by summarizing its ruling as follows:

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

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

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

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

b. **Summary of Court Analysis.** For a summary of the majority, concurring, and dissenting opinions in *Loper Bright*, see Item 30.b.-d. of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (Dec. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

c. **Observations.**

(1) **Overview Regarding Estate Tax Regulations.** In the much celebrated (at least by taxpayers) case of *Walton v. Commissioner*, 115 T.C. 589 (2000), the Tax Court invalidated the notorious Example 5 in the GRAT regulations (Reg. §25.2702-3(e), Ex. (5)) as being "an unreasonable interpretation and an invalid extension of section 2702." The court applied the *Chevron* deference test to determine whether this "interpretive regulation" was reasonable (as opposed to the stricter "arbitrary, capricious, or manifestly contrary to the statute" test for "legislative regulations" issued under a specific grant of authority in the pertinent statute). The court said that it did not need to reach the issue of whether the regulation was adopted in violation of the APA. The holding in *Walton* allows the full actuarial value of the retained annuity interest in a GRAT to be subtracted in determining the net value of the gift upon the creation of a GRAT (thus almost or perhaps completely "zeroing out" the GRAT). After focusing on the statute's "origin and purpose for further guidance," *Walton* viewed the restriction in Example 5 from netting the gift amount by the value of the reversionary interest passing to the donor's estate as "an unreasonable interpretation and an invalid extension of section 2702." 115 T.C. at 604.

Since that time almost twenty-five years ago, very few cases in the estate planning arena have addressed the validity of Treasury regulations and notices, and very few have addressed the invalidity of regulations for failure to comply with the APA or have validated regulations by reason of the *Chevron* doctrine.

(2) **Continuation of Recent Trend Attacking Regulations; Statute of Limitations Regarding Attacks on Old Regulations (*Corner Post, Inc. v. Board of Governors of the Federal Reserve System*).** *Loper Bright* is the latest link in a chain of recent attacks on the validity of regulations. See Item 25 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (Dec. 2024), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights,** for discussion about a number of recent cases beginning in late 2021 that have addressed the validity under the APA of regulations and other IRS guidance (not only for final regulations but also temporary regulations and even subregulatory guidance).

Indeed, the Supreme Court followed *Loper Bright* with an opinion several days later saying that the six-year statute of limitations "after the right of action first accrues" under 28 U. S. C. §2401(a) for claims against the United States would not bar attacks on even very old regulations as being in violation of the Administrative Procedure Act requirements for valid agency actions. The Court concluded that the six-year statute does not begin to run until a particular plaintiff is injured by agency action. *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. 799 (July 1, 2024) (J. Barrett writing for majority; Dissent by J. Jackson, jointed by J. Sotomayor and J. Kagan). Section 2401(a) has a six-year statute of limitations to challenge a final agency action. A practical problem with that limit is that the Anti-Injunction Act (§7421(a)) prevents challenges to tax regulations until a taxpayer is affected (i.e., has a notice of deficiency, a refusal of a refund, or other dispute with the IRS). *CIC Services LLC v. United States*, 593 U.S. 209 (2021). That may be far longer than six years after the regulation was finalized. When taxpayers have challenged some regulations, the government has argued that the statute of limitations had run under 28 U.S.C. §2401(a) on the taxpayer's ability to challenge the regulation's validity. Under *Corner Post*, old regulations may still be challenged, as long as the challenge is brought within six years of when a taxpayer is injured by the regulation. Some commentators suggest that "*Corner Post* is a much bigger deal for tax than *Loper Bright*," with its opening of old regulations to challenges. *See* Sheppard, *Supreme Court Reverses* Chevron *Doctrine*, 184 TAX NOTES FEDERAL 379 (July 15, 2024).

(3) **General Application to Tax Regulations.** *Mayo Foundation v. U.S.*, 562 U.S. 44 (2011), regarding the validity of a Treasury regulation that impacted a requested refund of FICA taxes, specifically held that *Chevron* deference applies to tax regulations. "[W]e are not inclined to carve out an approach to administrative review good for tax law only.… The principles underlying our decision in *Chevron* apply with full force in the tax context." 562 U.S. at 55. *Mayo Foundation* rejected an argument that tax matters should be treated differently than other areas of administrative law. That meant that issues that had been raised regarding agency interpretations prior to *Chevron* (such as whether agency interpretation had been consistent or had been promulgated years after the relevant statute was enacted or because of the way in which the regulation evolved or because the regulation was prompted by litigation) would not apply to the Court's review of the FICA regulation.

(4) **Effect of Specific Statutory Authorization for Regulations**. *Loper Bright* briefly referred to the effect of statutory authorizations to promulgate regulations, saying that courts "interpret the statute and effectuate the will of Congress … by recognizing constitutional delegations, 'fix[ing] the boundaries of [the] delegated authority,' … and ensuring the agency has engaged in 'reasoned decisionmaking' within those boundaries." A statutory delegation of rulemaking authority will trigger some degree to deference. As suggested in the *Loper Bright* Court's brief statement, the court will first determine if there has been a constitutionally permissible delegation (recognizing that legislation is up to Congress not the executive branch and Congress cannot authorize agencies, in essence, to legislate on its behalf), This has been referred to as the "nondelegation doctrine." Second, the court will determine and scope of the delegation, and third, the court will determine if the agency has engaged in 'reasoned decisionmaking' within the scope of that authorization.

The New York State Bar Association Tax Section Report No.1508, *Comment on Tax Implications of* Loper Bright, (March 7. 2025), is an outstanding detailed analysis of the nondelegation doctrine and the effect of differing types of statutory regulatory delegations. It observes that courts have been lenient in applying the nondelegation doctrine; no statutes have been invalidated on these grounds since 1935. But some Supreme Court Justices have expressed a desire to revisit this doctrine to make it more restrictive. The Report suggests that being specific in delegations of rulemaking authority can assist in identifying the specific scope of the authority, in determining whether the agency's response was appropriate, and in satisfying the nondelegation doctrine. A case pending before the Supreme Court may provide updated guidance regarding the nondelegation doctrine. See Item 22.c(6) below.

Republican senators have formed the "Post-Chevron Working Group" to outline recommendations for drafting statutes In a way that would limit the ability of agencies to write regulations in an overly broad manner. A 150-page report by that group includes a section entitled "Legislative Drafter's Guide to Deference, Delegation, and Discretion." It suggests that statutes should avoid using words such as "arbitrary and/or capricious," "as defined by the Secretary," "and other measures," "appropriate," "reasonable," and "necessary." *See* Maeve Sheehey, *GOP Senators Map Path to Curb Agency Clout After Chevron's Death*, BLOOMBERG DAILY TAX REPORT (June 5, 2025).

Many Treasury regulations have been promulgated pursuant to the Treasury Department's general authority under §7805 to "prescribe all needful rules and regulations for the enforcement of" the Internal Revenue Code. Prior to *Chevron*, several Supreme Court cases said the Court owed less deference to the Treasury Department's interpretation that is issued under that general authority in §7805(a) than when it is issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision. *Rowan Cos.* v. *United States*, 452 U.S. 247, 253 (1981); *United States* v. *Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982) (quoting *Rowan*). That changed, however, following the *Chevron* case. *Mayo Foundation* stated that the administrative landscape changed significantly after *Rowan* and *Vogel* were decided. 562 U.S. at 56.

> We have held that *Chevron* deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." [*United States v. Mead Corp.*], 533 U. S., at 226–227. **Our inquiry in that regard does not turn on whether Congress's delegation of authority was general or specific.**

562 U.S. at 56-57 (emphasis added).

That statement by the Supreme Court in 2011, drawing no distinction between general or specific delegations of authority to the Treasury Department in tax statutes, appears to be a change in the position taken by the Court in *Chevron*, which applied a high standard for disregarding "legislative regulations" in response to "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. According to *Chevron*, such legislative regulations were given controlling weight unless they were arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. 837, at 843-844 (1984). Various cases after *Chevron* have drawn a distinction between interpretive regulations issued under the general authority of §7805(a) and legislative regulations issued under a specific grant of authority for a particular statute.

For example, the Tax Court in *Walton v. Commissioner*, 115 T.C. 589 (2000), invalidated the notorious "Example 5" in the initial GRAT regulations by applying a "reasonable manner" standard for interpretive regulations, as opposed to the much stricter "arbitrary, capricious, or manifestly contrary to the statute" standard for reviewing legislative regulations.

> The regulations at issue here are interpretative regulations promulgated under the general authority vested in the Secretary by section 7805(a). Hence, while entitled to considerable weight, they are accorded less deference than would be legislative regulations issued under a specific grant of authority to address a matter raised by the pertinent statute. See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-844 (1984) (Chevron); United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 [49 AFTR 2d 82-491] (1982). A legislative regulation is to be upheld unless "arbitrary, capricious, or manifestly contrary to the statute." Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., supra at 843-844.
>
> With respect to interpretative regulations, the appropriate standard is whether the provision "implement[s] the congressional mandate in some reasonable manner." United States v. Vogel Fertilizer Co., supra at 24 (quoting United States v. Correll, 389 U.S. 299, 307 [20 AFTR 2d 5845] (1967)). In applying this test, we look to the following two-part analysis enunciated by the Supreme Court [in *Chevron*].

115 T.C. at 597.

Other cases (prior to *Loper Bright*) have acknowledged that the issuance of a regulation after following the notice-and-comment procedures of the APA are a "significant" sign that the

regulation merits *Chevron* deference. *Mayo Foundation*, *United States v. Mead Corp.*, *Long Island Care at Home Ltd. v. Coke*.

The Court in *Loper Bright* did not specifically address the effect of general vs. specific statutory authority for issuing regulations. The Court acknowledged that different types of statutory authority may exist for issuing regulations.

> In a case involving an agency, of course, the statute's meaning may well be that the agency is authorized to exercise a degree of discretion. Congress has often enacted such statutes. For example, some statutes "expressly delegate[]" to an agency the authority to give meaning to a particular statutory term. *Batterton* v. *Francis*, 432 U. S. 416, 425 (1977) (emphasis deleted). Others empower an agency to prescribe rules to "fill up the details" of a statutory scheme, *Wayman* v. *Southard*, 10 Wheat. 1, 43 (1825), or to regulate subject to the limits imposed by a term or phrase that "leaves agencies with flexibility," *Michigan* v. *EPA*, 576 U. S. 743, 752 (2015), such as "appropriate" or "reasonable." [footnotes omitted]

Slip Opinion at 17.

The Court did not refer to how its analysis would vary depending on the type of statutory authorization other than to recognize that courts should determine the boundaries of the delegated authority and ensure "that the agency has engaged in 'reasoned decisionmaking' within those boundaries." Slip Opinion at 18. The end of the majority's opinion in *Loper Bright* merely observes that "when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous." The only limitation specifically mentioned is that the courts "must respect the delegation" and must determine that regulations that are issued are within the scope of the delegated authority. However, some commentators believe that under *Loper Bright*, regulations issued pursuant to a specific grant of authority will continue to be afforded more weight than mere interpretive regulations issued under §7805's general grant of authority. *E.g.*, Mitchell Gans & Jonathan Blattmachr, *Loper Bright Enterprises v. Raimondo, Where in a Generational Shift, the Supreme Court Overruled the Chevron Doctrine*, LEIMBERG ESTATE PLANNING NEWSLETTER #3130 (July 2, 2024) (hereinafter Gans & Blattmachr, Generational Shift).

All tax regulations are issued under the general authority of §7805, stating that "the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." But some regulations are also issued under more specific statutory authority, typically included in the relevant Code provision.

For example, Ron Aucutt (Lakewood Ranch, Florida) points to the "consistent basis" proposed regulations. Section 1014(f) specifically authorizes regulations to "provide exceptions to the application of this subsection." Mr. Aucutt asks: "Does that permit regulations that assign a zero basis to an after-discovered or accidentally omitted asset, even though its value has been neither "determined" under §1014(f)(1)(A) nor reported under §1014(f)(1)(B) and therefore it appears that §1014(f) does not apply to that asset at all? I don't think so." In contrast, §6035 requires providing basis information to recipients, and §6035(b) authorizes regulations that are "necessary to carry out" §6035. Mr. Aucutt points out that Treasury officials have informally cited §6035(b) "to perhaps justify requiring the successive reporting by donors and other transferors in non-realization transfers, but §6035 only requires reporting and does not assign basis like §1014(f) does. Moreover, even §6035(b)'s use of 'necessary' may be viewed as weak compared to the 'necessary or appropriate' standard in §2001(g)(2) (clawback) and §2010(c)(6) (portability)."

Relatively very few of the Code sections regarding estate and gift taxes include specific statutory authorization for regulations. Some exceptions include §2001(g)(2) (clawback, "necessary or appropriate"), §2010(c)(6) (portability, "necessary or appropriate"), §2014(c)(2) foreign tax credit, "regulations prescribed by the Secretary"), §2016 (recovery of taxes claimed as credit, "regulations prescribed by the Secretary"), §2014(c)(2) foreign tax credit, "regulations prescribed by the Secretary"), §2032A(f)(1) (special use valuation statute of limitations, "such manner as the

Secretary may be regulations prescribe"), §2037(b)(2) (value of reversionary interest, "regulations prescribed by the Secretary"), §2053(d)(1) (deductibility of certain foreign death taxes, "regulations prescribed by the Secretary"), §2055(e)(H) (estate tax charitable deduction, "as may be necessary to carry the purposes of this paragraph"), §2056A(a)(2) and (e) (qualified domestic trusts, "may by regulations prescribe to ensure the collection of any tax imposed by subsection (b)" and "[t]he Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section"), §2108(d) (application of pre-1967 estate tax provisions regarding taxes paid to foreign country, "necessary or appropriate to implement this section"), §2204(b) (discharge of fiduciary from personal liability, "for purposes of carrying out the provisions of this section as the Secretary may require by regulations"), §§2513 (a)(2), 2513(b), and 2513(c) (split gift election, "such manner as is provided under regulations"), §2522(e)(1)(B) (gift tax charitable deduction limitations for fractional gifts, "may, by regulation, provide"), §2522(e)(2)(A) (gift tax charitable deduction recapture, "Secretary shall provide"). Section 2663 authorizes regulations "as may be necessary or appropriate" regarding all the generation-skipping transfer tax Code provisions (and specifically including three listed topics). That leaves most of the estate and gift tax Code sections with no specific authorization for regulations. In summary, **very few** estate and gift tax regulations have been issued pursuant to specific statutory authority other than the general authority of §7805.

Some commentators maintain that when an issue does not involve the interpretation of statutory law, IRS regulations should receive deference in court because they are promulgated under an effective delegation of authority in §7805(a). Joseph Olivieri, *Tax Regulations After* Loper Bright, TAX NOTES TODAY (Oct. 28, 2025).

For an outstanding discussion of the importance of whether and how courts may restrict the scope of express delegations to write regulations, see Jasper Cummings, Chevron: *How to Read a Supreme Court Opinion*, 185 TAX NOTES FEDERAL 87 (Oct. 7, 2024).

(5) **Supreme Court Case Suggests that Rulemaking Authorizations Similar to §7805 May Not Support a Higher Level of Deference Than *Skidmore* Deference*, Bondi v. VanDerStok,* 604 U.S. __ (March 26, 2025).** The Supreme Court considered the validity of a federal agency rule that was promulgated pursuant to statutory authority similar to §7805. In 2022, the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) adopted a new rule designed to combat the proliferation of ghost guns, invoking authority Congress granted to the Attorney General to prescribe "only such rules and regulations as are necessary to carry out" the Gun Control Act. 18 U.S.C. §926(a). (The rule-making authority was granted to the Attorney General, who delegated the authority to the ATF.) Section 7805 has similar language, In analyzing the validity of the rule, the Supreme Court quoted *Loper Bright* in observing that "while 'courts must exercise independent judgment in determining the meaning of statutory provisions,' the contemporary and consistent views of a coordinate branch of government can provide evidence of the law's meaning." *Vanderstok*, 145 S. Ct. at 864. Reference to the "contemporary and consistent views of a coordinate branch of government" is presumably a reference to the *Skidmore* standard, though *Vanderstok* does not cite *Skidmore*. The Court applied that standard rather than greater deference that might be afforded to rules promulgated pursuant to specific grants of rulemaking authority for the implementation of a statute. *See* Mitchell Gans, *Has the Supreme Court Already Resolved How* Loper Bright *Applies to Section 7805 Regulations?*, 187 TAX NOTES FEDERAL 1069 (May 12, 2025). The concurring opinion by Justice Jackson reasoned that the agency rule was consistent with delegated rulemaking authority: "Proper excess-of-authority review must focus on actual statutory boundaries, not on whether the agency's discretionary choices overlap precisely with what we, as unelected judges, would have done if we were standing in the agency's shoes."

(6) **Supreme Court Holds that Nondelegation Doctrine Does Not Invalidate Administrative Rule*, Federal Communications Commission v. Consumers' Research.*** In *Federal Communications Commission v. Consumers' Research*, 109 F.4th 743 (5th Cir. 2024), the Fifth Circuit applied the nondelegation doctrine to void a delegation of rulemaking authority to the Federal Communications Commission. It stated:

> Vague congressional delegations undermine representative government because they give unelected bureaucrats — rather than elected representatives — the final say over matters that affect the lives, liberty, and property of Americans. . . . Nondelegation inquiries "always begin . . . with statutory interpretation" because the constitutional question is whether Congress has supplied a sufficiently intelligible principle to guide an agency's discretion.

The FCC case was appealed to the Supreme Court, and case was argued on March 26, 2025.

Possible implications of that case were summarized in an article by Monte Jackel:

> As stated above, the nondelegation doctrine is based on the exclusive legislative power being vested in Congress. The question in a particular case is determined based on whether the congressional grant contains enough specificity so that the intent of Congress in that statute cannot be overridden by an executive agency through a grant to write regulations (or otherwise).
>
> …
>
> The primary issue in the case is whether the nondelegation doctrine continues to apply in its present vague and loosely worded form — where the asserted intelligible principle underlying the grant is easily found by a reviewing court as justifying the grant — or whether the doctrine applies as a much stricter guardrail on when Congress can delegate certain actions to a federal agency by looking critically at the asserted intelligible principle cited to support the grant. This issue comes down to whether Congress was specific enough in its grant that it can be said that the substance of the regulation issued under the grant is consistent with congressional intent. That, of course, depends on whether congressional intent itself was clearly expressed by Congress by applying the standard tools of statutory interpretation.
>
> …
>
> If the Supreme Court applies the nondelegation doctrine in the FCC case, many tax regulations that grant authority to the IRS to write rules "to be consistent with the purpose of the statute," or otherwise worded, could be held invalid if the delegation lacks specifics in its grant or the asserted intelligible principle to support the grant is not credible.

Monte Jackel, *Supreme Court May (or May Not) Invalidate Delegations to Tax Regs*, 187 TAX NOTES FEDERAL 165 (April 7, 2025).

The Supreme Court reversed in a 6-3 decision, holding that held that the Universal Service Fund (USF) contribution structure does not violate the nondelegation doctrine. Congress provided sufficiently concrete, guiding standards—such as defining beneficiaries (e.g., rural areas, low-income consumers, schools, libraries), requiring services to be essential to education, public health, or public safety, and mandating affordability—to satisfy constitutional requirements. The Court also rejected challenges based on the so-called "private non-delegation" doctrine—namely, the argument that the FCC unlawfully delegated its authority to a private entity (the Universal Service Administrative Company, or USAC). The Court affirmed that USAC acts in a subordinate, advisory role, and that the FCC retains final decision-making authority. Justice Gorsuch, joined by Justices Thomas and Alito, dissented, arguing that the decision improperly allows too much legislative power to be exercised by an agency. *Federal Communications Commission v. Consumers' Research*, 606 U.S. __ (No. 24-354 June 27, 2025).

(7) **Review Standards Prior to *Chevron (Skidmore* and *National Muffler).*** Before the *Chevron* decision in 1984, courts had typically used the review standards originally announced by the Supreme Court in 1944 in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944):

> We consider that the rulings, interpretations and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority; do constitute a **body of experience and informed judgment** to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon **the thoroughness** evident in its consideration, the **validity of its reasoning**, its **consistency** with earlier and later pronouncements, and all those factors which give it **power to persuade**, if lacking power to control.

323 U.S. at 140 (emphasis added).

Factors mentioned by *Skidmore* (in the quotation immediately above) that courts should consider in determining what weight to give to agency interpretations in looking to them for "guidance"

are (1) their thoroughness, (2) the validity of their reasoning, (3) their consistency with earlier and later pronouncements, and (4) all factors relevant to their power to persuade.

The Supreme Court subsequently summarized *Skidmore* as saying an agency's interpretation of a statute is entitled to "respect proportional to its 'power to persuade.'" *United States v. Mead Corp.*, 533 U.S. 218, 235 (2001) (quoting *Skidmore*).

The *Skidmore* analysis was applied with more detail by the Supreme Court in *National Muffler Dealers Assn. v. United States*, 440 U.S. 472 (1979).

> In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation **harmonizes with the plain language of the statute, its origin, and its purpose**. A regulation may have particular force if it is a **substantially contemporaneous** construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a **later period, the manner in which it evolved merits** inquiry. Other relevant considerations are the **length of time** the regulation has been in effect, the **reliance** placed on it, the **consistency** of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during **subsequent re-enactments of the statute**.
>
> …
>
> In short, while the Commissioner's reading of 501(c)(6) perhaps is not the only possible one, it does bear a fair relationship to the **language of the statute**, it reflects the **views of those who sought its enactment**, and it matches **the purpose** they articulated. It **evolved as the Commissioner administered the statute** and attempted to give to a new phrase a content that would reflect congressional design. The regulation has **stood for 50 years**, and the Commissioner infrequently but **consistently** has interpreted it to exclude an organization like the Association that is not industrywide. The Commissioner's view therefore merits serious deference.

440 U.S. at 477-78 (emphasis added).

(8) **Does the *Skidmore* Review Standard Apply Following *Loper Bright*?** *Loper Bright* does not specifically address what standard should be used by courts in reviewing whether regulations appropriately interpret statutory provisions. Some commentators have suggested that following *Loper Bright*, courts will consider "the relevant factors under *Skidmore* deference." *E.g.*, Gans & Blattmachr, Generational Shift. Other commentators believe that the standard to be applied after the overruling of *Chevron* is not clear. *See Skidmore Deference: Agency Actions Without the Force of Law*, BLOOMBERG LAW (July 2024) ("The *Skidmore* standard was cited in the briefs in *Loper Bright* and *Relentless*, and was the subject of questions during oral argument as well. It's a frontrunner to be a *Chevron* replacement, though nothing is certain yet.").

The first post-*Loper-Bright* Tax Court case addressing the validity of a tax regulation quoted the *Skidmore* analysis at length. *Varian Medical System, Inc. v. Commissioner*, 163 T.C. No. 4 (2024). See Item 23.a below.

One commentator believes that the *Skidmore* framework will be applied, observing that it is not "deference" to agency interpretation (*Loper Bright* emphasizes that courts interpret and construe statutes and should never "defer" to agency interpretations) but is a process for "uncovering statutory meaning."

> … [I]n *Loper Bright* the Court not only cited *Skidmore* with seeming approval, but repeatedly emphasized the "respect" traditionally afforded to longstanding, consistent agency interpretations, especially when offered close in time to the statute's passage….
>
> … But it doesn't want to call *Skidmore* "deference," because it believes the thing called deference is not allowed under the APA. And so we also get some language endorsing de novo review.
>
> … *Skidmore* is really about uncovering statutory meaning. So, the *Loper Bright* majority might say, using it does not constitute deference any more than consulting a dictionary does. *Chevron* was different in that it was premised on the idea that the law had "run out," and the agency simply got to decide the question. *Loper Bright* seems to embrace something like this distinction in footnote 3.

Daniel Deacon, *Loper Bright, Skidmore, and the Gravitational Pull of Past Agency Interpretations*, BLOG FROM YALE JOURNAL ON REGULATION AND AMERICAN BAR ASSOCIATION ADMINISTRATIVE LAW AND REGULATORY PRACTICE SECTION (June 30, 2024).

The contrast between the "uncovering statutory meaning" approach of *Skidmore* and the "deference" approach of *Chevron* was explained in Ryan Doerfler, *How Clear is "Clear"?*, 109 VA. L. REV. 651, 709 (2023) ("unlike *Chevron*, however, *Skidmore* appears to treat an agency's views as evidence of statutory meaning…. Again, under *Skidmore*, an agency's views are evidence of statutory meaning. Under *Chevron*, by contrast, those views constitute a legal basis for deciding a case if statutory meaning is unknown.").

(9) **Possible Practical Implications of *Loper Bright* on Tax Regulations Going Forward.** For a detailed discussion of a variety of possible implications of *Loper Bright*, see Item 30.e.7. of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (Dec. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(a) **More Attacks on Validity of Regulations.** The overruling of *Chevron* deference will allow much more flexibility to courts in reviewing the validity of regulations and whether they correctly reflect the "plain language…, … origin, and … purpose" (quoting *National Muffler*) of pertinent statutes, likely leading to more attacks on the validity of regulations. "No longer will the IRS be entitled to a near-automatic win if it can establish that the statute is ambiguous. No longer is it a *fait accompli* that a court will uphold a challenged regulation." Thomas Sykes, Loper Bright: *A Tax Litigator's Quick Take*, 184 TAX NOTES FEDERAL 451 (July 15, 2014) (hereinafter Sykes, Tax Litigator's Quick Take).

(b) **Trump Administration's Review of Existing Regulations.** Executive Order 14219 directs agency heads to identify regulations meeting any of seven characteristics, the first three of which relate directly to *Loper Bright*. Date. A Presidential Memorandum dated April 9, 2025, requires federal agencies to identify unlawful regulations, applying principles of various specific cases (one of which is *Loper Bright*), and take steps to repeal them without notice and comment. See Item 12 above.

(c) **Congress's Approach in Structuring Legislation.** *Loper Bright* may place more focus on structuring legislation to provide implementation details rather than risking how courts may interpret details as to the "best meaning" of a statute and how it should be implemented. Special attention will be devoted to any express delegation to Treasury in tax statutes to provide "needful rules and regulations" (§7805(a)). Courts will carefully analyze the scope of any such express delegation of rulemaking authority and whether Treasury has engaged in "reasoned decisionmaking" within those boundaries. See Item 22.c(4) above.

The Joint Committee on Taxation may play an even larger role going forward in crafting tax legislation and producing detailed legislative history.

> The decision in *Loper Bright Enterprises v. Raimondo* holds big implications for tax policy, as Congress often gives the IRS and the Treasury Department leeway to fill in gaps in tax laws when crafting final regulations.
>
> Now, the House Ways and Means and Senate Finance committees may need to be more specific in delegating authority to the agencies and produce more detailed legislative histories for the courts to understand what Congress intended. Some lawmakers have said they may need backup from key partners like the Joint Committee on Taxation, which works closely with tax writers analyzing the impact of tax proposals.
>
> "The bulk of that is going to go on the Joint Committee staff, if Congress is serious in writing bills that they actually want to do and not letting the courts rewrite it," said George Yin, who served as the chief of staff at the JCT from 2003 to 2005.
>
> …

> Depending on how courts approach the legal challenges, there may be a greater emphasis on the legislative history and committee reports that the JCT is a key player in drafting, said Steve Rosenthal, a senior fellow at the Urban-Brookings Tax Policy Center who previously served as a legislation counsel at JCT.
>
> Congress will need help from JCT in choosing how to delegate authority to the IRS and Treasury and explaining the context, but JCT is prepared to take on that task, Rosenthal said.

Handler, *Congress's Tax Scorekeeper Gets Spotlight After Chevron Ruling*, BLOOMBERG DAILY TAX REPORT (July 23, 2024).

(10) ***Loper Bright* May Lead to Increased Executive Branch Actions, Driving Policy Making "Into the Shadows."** Prior IRS Commissioner Danny Weurfel suggests that the Supreme Court in *Loper Bright* may have wanted to rein in the executive branch's reliance on implied authority in statues by limiting deference given to actions by executive branch agencies (including in regulations), but the decision may have had the opposite effect. The executive branch may be incentivized to take direct executive actions rather than going through the regulatory rulemaking process. The current Administration has dramatically expanded its power "by reading into the law implied, not explicit, authorities." For example, the IRS is sharing taxpayer data with immigration enforcement, removing career civil servants and appointees at independent oversight bodies, and restructuring or eliminating federal agencies under claimed executive authority despite statutes seeming to preclude such actions and without new legislative mandates.

> So I'm left wondering: Whatever happened to *Loper Bright*?
>
> One answer offered by legal experts is that *Loper Bright* is solely about regulations—that it only matters when an agency acts through notice-and-comment rulemaking and asks a court to defer to its interpretation of an ambiguous statute. On this narrow reading, executive branch actions such as data sharing, enforcement discretion, or even agency restructuring might escape *Loper Bright*'s reach altogether.
>
> If that's the case, we may have created a dangerous incentive. Federal agencies increasingly could choose to act outside of the rulemaking process, precisely to avoid the new constraints of *Loper Bright*. The very doctrine that was supposed to cabin agency authority could instead drive more policy making into the shadows at the drop of a hat, without the transparency that rulemaking requires.
>
> The irony isn't hypothetical. It's already playing out in one of the most consequential tests of executive authority unfolding inside the IRS.
>
> Nowhere is the tension sharper than in the administration's interpretation of Section 6103 of the Internal Revenue Code—one of the most tightly drawn provisions in all of tax law. Despite its meticulous limits and its silence on immigration, the Trump administration has concluded that it may share confidential taxpayer data with the Department of Homeland Security for immigration enforcement.
>
> The legal hook is an "implied" authority—an argument that a broad data-sharing program can fit beneath what was once a narrow allowance for case-specific criminal investigations.
>
> In the world before *Loper*, I might have seen the case for such reasoning, though even then I would have been skeptical. After *Loper*, I would have thought there was no chance. If the IRS wanted to share taxpayer information with an agency not explicitly named in the statute, it would need to go to Congress and get the law changed.
>
> Yet here we are. Taxpayer data is flowing, and lawsuits are flying….
>
> But the larger question was missing: After *Loper Bright*, can an agency rely on "implied" authority at all?
>
> We deserve clarity on this point, because the stakes are immense. **The Supreme Court itself invited a recalibration of the balance between Congress and executive branch. Yet in practice, executive action seems to be rolling along as if *Loper Bright* never happened. The current trend feels less like *Chevron's* demise and more like its expansion.**
>
> If *Loper* really changed the law, we need to see it in action. If it didn't, then agencies and the public deserve to know that, too.

Danny Werfel, Executive Branch Power Grows as Loper Bright Order Fades: Werfel, BLOOMBERG DAILY TAX REPORT (Oct. 17, 2025) (emphasis added).

23. Regulation Validity Issues Post-Loper Bright; Mechanisms for Attacking Regulation Validity; Anti-Injunction Act.

a. **Tax Court Approach Going Forward; IRS Cannot Fix Statutory Mistakes With Regulations, *Varian v. Commissioner*.** The Tax Court acted quickly to give its first view of the new post-*Loper Bright* world in *Varian Medical System, Inc. v. Commissioner*, 163 T.C. No. 4 (2024). A "glitch" in the 2017 TCJA created (allegedly) unintended benefits for certain corporate taxpayers. A Technical Correction Act was never passed, and the IRS tried to remove the advantage by regulations. The Tax Court, in a unanimous opinion issued soon after the *Loper Bright* case, reasoned that the statute was clear and applied the statute as written. That could have decided the case, but the court went further, addressing the regulation at length and providing a roadmap for how it would evaluate challenges to regulations going forward. It quoted *Skidmore* analysis of factors at length, noting this factor in particular: "Does the statute authorize the challenged agency action?" The Tax Court concluded: "No matter what the revised regulation intended to interpret, it cannot contradict the clear effective date provided for in the statutory text." *See also FedEx Corp. v. United States*, Cause No. 2:20-cv-02794 (W.D. Tenn February 13, 2025) (grant of motion for partial summary judgment denying reduction of $84.6 million refund, which was based on tax credits for taxes paid on foreign subsidiaries, referring to *Loper Bright* in concluding that IRS arguments "ignore the plain language of the dispositive statutory provisions").

   If the IRS cannot fix statutory glitches by regulation, it might be expected to use common law doctrines like economic substance or substance over form to attack what it views as abusive transactions.

b. **Possibility of Court Attacks on Taxpayer-Friendly Regulations, *Memorial Hermann*.** An accepted principle is that the *IRS* cannot disavow its own regulations if it ultimately determines that a regulation takes a too-friendly taxpayer approach. However, a recent case suggests that taxpayers cannot blindly rely on regulations—the *court* on its own accord invalidated a regulation as providing a taxpayer-friendly approach that goes beyond the statutory authority. The issue was whether an organization qualified as a social welfare organization under §501(c)(4). The statute requires that such organizations be "operated exclusively for the promotion of social welfare." The Supreme Court has interpreted "operated exclusively" in other contexts to mean the presence of a single substantial nonexempt purpose will preclude exempt status. However, the regulations state that an organization will be treated as being "operated exclusively" for a social welfare purpose "if it is primarily engaged in promoting in some way the common and general welfare" of the community. Reg. §1.501(c)(4)-1(a)(2)(i). The ordinary meaning of "primarily engaged" (at least 51%) is much less restrictive than an "operated exclusively" standard. The IRS did not argue against its own regulation but contended that the "primarily engaged" and "operate exclusively" standards were not meaningfully different. The court determined that the organization did not meet either test, but the court went on to reject the taxpayer's reliance on the regulation: "Importantly, we no longer are required to provide '*Chevron* deference' to the Treasury's interpretation of § 501(c)(4) (although we can certainly consider it)… [T]he IRS's embrace of a legal standard cannot supplant our independent interpretation of the statutory text." *Memorial Hermann Accountable Care Org. v. Commissioner*, 120 F.4th 215 (5th Cir. Oct. 28, 2024).

   There was no briefing regarding the validity of the regulation, and no party argued the regulation was invalid, but the court *sua sponte* disregarded the regulation. Neither party has an incentive to appeal; the government won and the taxpayer would lose even under the regulation's test. The case creates uncertainty about the ability of planners to rely on regulations. Do not overread the case, however; panelists noted it was not briefed, it is not well reasoned, and the comment questioning the regulation was a "throwaway line."

c. **Methods of Attacking Validity of Regulations; Anti-Injunction Act.** Only three possibilities exist for bringing a court action to test the validity of tax regulations:

(1) Going through an examination, appeals, and having a Notice of Deficiency issued (which can take years), at which time a Tax Court petition could be filed;

(2) Filing a return consistent with the regulation and paying tax, filing a claim for refund taking the position that the regulation is invalid, and eventually filing an action in the District Court (but that may require paying a big tax up front unless the issue could be raised in a small transaction with a small tax at risk); or

(3) Filing suit in district court contesting the regulation's validity under the Administrative Procedure Act; but the Anti-Injunction Act (codified in §7421(a)) broadly prohibits lawsuits that aim to restrain the assessment or collection of taxes, with some specified exceptions. Its counterpart in the Declaratory Judgment Act (28 U.S.C. §2201) reinforces this prohibition by excluding tax matters from declaratory relief. To the contrary, an attack on the validity of agency action requiring onerous information reporting (for example, for "Reportable transactions") that is not directly related to a tax liability but merely relates to information the government may use to determine whether to audit a transaction is not prohibited by the Anti-Injunction Act. The Supreme Court has agreed these types of cases are not barred by the Anti-Injunction Act because they involve an issue separate from the tax itself, but they have potential civil or criminal penalties. *CIC Services LLC v. United States*, 593 U.S. 209 (2021).

In summary, the Anti-Injunction Act (§7421(a)) prevents challenges to tax regulations until a taxpayer is affected (i.e., has a notice of deficiency, a refusal of a refund, or other dispute with the IRS). Federal agencies' actions other than tax regulations do not have this problem; for example, the CTA regulations can be attacked directly because they would not forestall collection of a tax. See *CIC Services LLC v. United States*, 593 U.S. 209 (2021) (regulations prescribing reporting requirements can be challenged pre-enforcement without violating the Anti-Injunction Act or the Declaratory Judgment Act).

An attack on a regulation can be either a procedural challenge (for failure to follow the procedural requirements of the Administrative Procedure Act) or substantive challenge (the regulation is ambiguous and unreasonable on its face or takes an arbitrary and capricious position not supported by the statute).

Indeed, the six-year statute of limitations "after the right of action first accrues" for claims against the United States under 28 U. S. C. §2401(a) would not bar *substantive challenges* to regulations because the statute does not begin to run until a particular plaintiff is injured by agency action. *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. 799 (July 1, 2024). However, a cryptic footnote near the end of the opinion suggests the opinion was not dealing with procedural challenges to regulations, so some question remains as to the period of limitations for raising procedural challenges to regulations.

d. **Available Remedies; Nationwide Injunctions.** A hotly debated issue is whether the appropriate remedy, if a court finds a regulation to be invalid, is to enjoin enforcement of the regulation nationwide for all parties, or just for the parties in the suit. The APA authorization to "set aside" an agency action is unclear as to whether that means the action should really be "set aside" as if it does not exist, meaning it would not be enforced against anyone. This is referred to as a "universal vacatur." A concurring opinion by Justice Cavenaugh in *Corner Post* takes the position that the APA does authorize a vacatur of agency actions. He concludes: "The Government's newly minted position [that the APA does not allow vacatur] is both novel and wrong. It 'disregards a lot of history and a lot of law.' M. Sohoni, The Past and Future of Universal Vacatur, 133 Yale L. J. 2305, 2311 (2024)."

This is a difficult issue. On the one hand, requiring every separate individual injured by a regulation to bring a lawsuit challenging the regulation is wasteful. On the other hand, is it appropriate to give a single district judge the power to invalidate a regulation throughout the nation for all parties? That issue is now involved in the lawsuits challenging the constitutionality of the CTA and regulations requiring the filing of beneficial ownership reports. A nationwide injunction is now in place, and the Supreme Court may ultimately rule on whether a nationwide temporary injunction is appropriate for

the CTA cases while the constitutionality of the statute and regulation is being determined. See Item 19.d above.

The Supreme Court, in *Trump v. CASA, Inc.*, recently held that federal district courts lack the authority under the Judiciary Act of 1789 to issue nationwide injunctions blocking enforcement of executive branch policies beyond the specific parties in a case. Justice Amy Coney Barrett, writing for the majority, emphasized that equity relief must be tailored to provide "complete relief" to the plaintiffs, rather than sweeping, universal relief. As a result, preliminary nationwide injunctions against Trump's Executive Order 14160 (a birthright citizenship directive) were partially stayed—only to the extent they overreached beyond what was necessary for plaintiffs before the court. *Trump v. CASA, Inc.,* 606 U.S. ___ (No. 24A884) (June 27, 2025).

24. Taxation of Unrealized Amounts Other Than as an Income Tax, *Moore v. United States,* 602 U.S. __ (June 20, 2024)

a. **Very Brief Synopsis.** Lowers courts held that taxpayers were liable for the "mandatory repatriation tax" imposed by the 2017 TCJA. It applied to U.S. persons owning at least 10% of the stock of a controlled foreign corporation in 2017 on undistributed post-1986 earnings. These earnings had not been realized directly by the taxpayers but they were still in the corporations. Lower courts held that the tax was not constitutional because of its retroactive application. Taxpayers also argued that the tax was unconstitutional under the Apportionment Clause of the U.S. Constitution (Art. I, Section 9, Clause 4) which prohibits any "direct tax" that is not apportioned among the states according to their population. However, the Sixteenth Amendment authorizes tax on "incomes, from whatever source derived." The Ninth Circuit held that the tax was constitutional and within the scope of the Sixteenth Amendment. The U.S. Supreme Court granted certiorari to the taxpayer's question that framed the issue: "Whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states." In effect, the question posed for which the Supreme Court accepted certiorari was whether the tax was an income tax authorized by the Sixteenth Amendment even though the sums subject to taxation had not been realized by the taxpayers.

   In a 7-2 decision, the Supreme Court found the tax to be constitutional. The Supreme Court's majority opinion, joined by five Justices, approved the tax, but it framed the issue much more narrowly, focusing on the attribution of income rather than realization. It cited a number of cases confirming that "Congress can attribute the undistributed income of an entity to the entity's shareholders or partners." Footnotes in the majority opinion directly stated, "we do not address the Government's argument that a gain need not be realized to constitute income under the Constitution" and that it did not address "taxes on holdings, wealth, or net worth … or … appreciation." Four Justices, in a concurring opinion and dissenting opinion, made clear that they view realization as a constitutional requirement.

b. **Significance.** The Supreme Court opinion had been anticipated as a possible seminal event regarding the government's taxation limitations. As suggested by the footnote in the majority opinion, it could have placed constitutional limitations on the ability to tax "holdings, wealth, … net worth, … or appreciation." For example, it could have placed constitutional limits on recent proposals for a wealth tax or taxation on deemed realization at the death of an individual. A strict realization requirement could have implications for a variety of Code provisions, such as the taxation of original issue discount, mark-to-market tax on dealers, §7872 deemed interest income, §678 income attributed to certain trust beneficiaries, the rules for taxing trusts and estates and partnerships, etc.

25. Step Transaction Doctrine Discussed in Connection with Purported Life Insurance Proceeds Inclusion Because of Alleged Lack of Insurable Interest, *Estate of Becker v. Commissioner,* T.C. Memo. 2024-89 (Sept. 24, 2024)

a. **Basic Facts.** The decedent loaned money to an irrevocable life insurance trust (Trust) to pay $1.7 million in premiums on two life insurance policies with a combined death benefit of $19.5 million. The decedent borrowed that $1.7 million from the insurance agent who in turn borrowed it from

another lender. Three months later the notes (secured by the policies) were assigned to a third party entity that committed to advance loans for future premiums (the third party entity never actually advanced additional loans). The decedent died unexpectedly in a car accident about a year and a half afterward, and the $19.5 million of death proceeds were paid to the Trust.

b. **IRS Position.** The IRS argued that the third party entity did not have an insurable interest in the policies and under Maryland law, the insured's estate was entitled to the death proceeds. However, the Trust that initially acquired the polices had an insurable interest, and under Maryland law a subsequent assignment of the policy would be legal whether or not the person had an insurable interest. Despite those Maryland law issues, the IRS argued that the estate was the beneficiary of the policy under a convoluted step transaction doctrine argument.

c. **Step Transaction Doctrine.** The step transaction doctrine has been applied under any of three separate tests:

(1) **"Binding Commitment Test."** "At the time that the first step is undertaken, the taxpayer was under a formal commitment to complete the remaining steps, often when a substantial period has passed between the steps that are subject to scrutiny."

(2) **"End Result Test."** "[T]ransactions will be collapsed if it appears that a series of formally separate steps are really prearranged parts of a single transaction intended from the outset to reach the ultimate result." This is a "subjective test that focuses on the parties' actual intent at the time that the transaction was entered into."

(3) **"Interdependence Test."** "The steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series."

(4) **Application to Facts.** None of those tests applied.

(a) The parties agreed that the "binding commitment test" did not apply (in part because there was no substantial period of time between the separate steps).

(b) The "end result test" did not apply because the third party "was unidentified at the time the … policies were issued."

(c) The "interdependence test" did not apply because no additional premiums would be required for 30 months, the decedent had enough assets to continue loans to the Trust to pay future premiums, and invoking the commitment by the third party to advance loans for payment of future premiums was not necessary.

d. **Court's Conclusion.** The step transaction doctrine does not apply. "Rather, the picture that emerges is that, of several financing options available to [the decedent] and the Trust to secure funding for possible future premiums, they simply chose the option that they viewed to be the most financially beneficial." There was no violation of Maryland's insurable interest doctrine, and the estate had no claim to the insurance proceeds, so there was no estate inclusion.

e. **Interesting Aside.** The financing agreement with the third party entity that committed to make advances to the Trust to pay future premiums provided that the third party would be repaid its advances plus interest **plus 75% of the policy proceeds**. Why would anyone agree to that??? The third party argued after the decedent's death that it was entitled to $14.8 million of the $19.5 million of the death proceeds; it eventually settled for $9 million (and it never actually advanced any additional funds to the Trust).

26. Section 2036 Applied to "Eve of Death" Funding of Limited Partnership by Decedent's Agent, *Estate of Fields v. Commissioner,* T.C. Memo 2024-90 (Sept. 26, 2024, corrected opinion issued Nov. 4, 2024)

a. **Synopsis.** Decedent's grand-nephew (N), acting under a power of attorney, for decedent transferred about $17 million of assets (all of her assets except $1.5 million of liquid assets and $600,000 of illiquid assets) to a limited partnership (LP) in return for a 99% limited partnership interest. N owned the LLC that was the 1% general partner. The LP and LLC were created and funded when decedent

was in "end stages" of Alzheimer's disease, and she died less than a month after the LP was funded (the largest asset contributed was transferred just 10 days before her death, after the decedent had been placed in hospice care). The assets retained by the decedent were not sufficient to satisfy her debts, cash bequests in her will, and estate taxes.

On these facts, it is not surprising that the court determined that the LP assets were included in the decedent's estate under §2036.

(1) §2036(a)(1): Acting through N as her agent, the decedent had access to the transferred assets (because N owned the LLC that was the general partner, which could control distributions from the LP); use of a significant portion of LP assets to pay various debts and expenses after one's death is evidence of a retained interest.

(2) §2036(a)(2): The partners unanimously could dissolve the LP, so the decedent (through N as her agent), in conjunction with others, could obtain the assets and then designate their disposition, citing *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017).

(3) The bona fide sale for adequate consideration exception to §2036 did not apply. The adequate consideration requirement was met (citing the test from *Kimbell v. United States*, 317 F.3d 257, 266 (5th Cir. 2004)), but the bona fide sale requirement was not met because there was no nontax reason as a significant purpose for creating the LP. Nontax reasons asserted by the estate were: (a) preventing financial elder abuse; (b) providing for management succession; (c) avoiding difficulties of managing assets under a power of attorney; and (d) streamlining of management.

The court listed eight reasons those were not viewed as actual purposes for creating the LP, including: (a) lack of planning prior to the decedent's precipitous declining health; (b) lack of contemporaneous documentary evidence of motivations for the transaction other than the attorney's reference to "obtaining deeper discounts"; (c) absence of business interests requiring active management; and (d) depletion of liquidity to the point post-death obligations could not be paid.

The §2043 analysis from *Estate of Moore v. Commissioner*, T.C. Memo 2020–40, was applied (but did not result in additional estate inclusion because the assets did not appreciate between the time of funding the LP and the time of death).

A 3.5% block of thinly traded company stock was entitled to an illiquidity discount, but the IRS's expert's 5.7% discount rather than the taxpayer's expert's 10% discount was used (because the IRS expert had a more detailed analysis of 32 transactions of private sales of restricted stock that could not be sold for 6-12 months and analogized that to a large block of stock).

The court applied the 20% accuracy-related penalty under §6662(a) & (b)(1) for underpayments attributable to negligence or disregard of rules or regulations. The reasonable cause and good faith exception did not apply. A reduction of $6.2 million in value by interposing an LP interest between the decedent and her assets "on the eve of death would strike a reasonable person in [N's] position as very possibly being too good to be true." Therefore, reasonable cause would not exist absent good faith reliance on professional tax advice, but there was no specific evidence that any professional advised that the assets could be reported at the claimed discount.

Estate of Fields v. Commissioner, T.C. Memo 2024-90 (Sept. 26, 2024, corrected opinion issued Nov. 4, 2024) (J. Copeland)

b. **Observations.**

(1) **Overview of §2036.** Section 2036(a)(1) requires estate inclusion of assets transferred with a retained right to possession or enjoyment of, or the right to income from the property.

Section 2036(a)(2) requires estate inclusion of property transferred with "the right, either alone or in conjunction with any other person, to designate the persons who shall possess or enjoy the [transferred] property or the income therefrom."

An exception applies under §2036, however, for a "bona fide sale for an adequate and full consideration in money or money's worth."

(2) **Action Under Power of Attorney on the Eve of Death; Decedent's Agent Controlling Distributions as General Partner.** The funding of an LP by an agent under a power of attorney on the eve of death is pretty uniformly the "kiss of death" against §2036 arguments. One of the facts causing estate inclusion under §2036(a)(1) was that N was the decedent's agent under a power of attorney and was also the owner of the LLC that was the general partner of the LP, and the general partner made distribution decisions for the LP. Therefore, decedent, through N as her agent, had access to all the LP assets, and the documents reflect an express retention of access to transferred assets.

(3) **Implied Retained Access to Pay Post-Death Obligations Is Sufficient to Invoke §2036(a)(1); Other Cases (But Not All) Have Also Applied This Reasoning; Planning Considerations.** Cases uniformly have held that a retained interest under §2036(a)(1) does not have to be express but can be implied. Although the decedent likely retained enough liquid assets outside the LP ($1.5 million) to cover her anticipated living expenses (due to her short life expectancy), the court reasoned that the necessity of obtaining distributions from the LP by the estate to cover post-death obligations (including cash bequests and estate taxes) demonstrated an implied agreement of retained enjoyment of the assets transferred to the LP.

Whether needing to access LP assets to satisfy post-death obligations triggers §2036(a)(1) has been addressed in many cases, with varying results. Attorneys have argued in various cases that post-death use of partnership assets should not be used as evidence of retained enjoyment by the decedent (§2036 refers to retained enjoyment by the decedent for life or for any period before death), but various cases have viewed the use of partnership assets to pay post-death obligations as reflecting retained enjoyment under §2036(a)(1). Those cases are *Rosen*, *Korby*, *Thompson*, *Erickson*, *Jorgensen*, *Miller*, *Liljestrand*, *Rector*, and *Beyer* (Tax Court cases) and the *Strangi* Fifth Circuit Court of Appeals case. *Miller* and *Erickson* are two cases in which the court looked primarily to post-death distributions and redemptions to pay estate taxes as triggering §2036(a)(1). In *Erickson*, T.C. Memo. 2007-107, the court emphasized particularly that the partnership provided funds for payment of the estate tax liabilities. (The only liabilities mentioned in the case were gift and estate tax liabilities.) The court viewed that as tantamount to making funds available to the decedent. Although the disbursement was implemented as a purchase of assets from the estate and as a redemption, "the estate received disbursements at a time that no other partners did. These disbursements provide strong support that Mrs. Erickson (or the estate) could use the assets if needed."

Interestingly, Judge Chiechi (the trial court judge in *Beyer*) was not troubled by post-death payments of estate taxes and other liabilities of the decedent's estate in *Estate of Mirowski v. Commissioner*. In *Mirowski*, the LLC distributed $36 million to the decedent's estate to pay transfer taxes, legal fees, and estate obligations. The court observed that the decedent's death was not anticipated at the time of the transfers, and there was no understanding to make LLC distributions to pay the taxes or other amounts due after her death. A distinction in *Mirowski* is that the decedent held a 52% interest in the LLC at her death that would have been sufficient to support the $36 million of distributions, but the distribution was not accomplished by purchasing assets from the decedent's estate or redeeming her interest in the LLC.

What if there are non-liquid assets in the estate and insufficient liquid assets for paying all post-death expenses? John Porter (Houston, Texas) has these recommendations:

(a) It is best is to borrow from a third party, but a bank may be unwilling to make a loan using only the partnership interest as collateral. The bank may want a guarantee by the partnership. If so, partnerships should be paid a guarantee fee. There is a legitimate reason for the LP to give a guarantee, because there will be an IRS lien against the partnership, and the partnership will not want the bank to foreclose on a partnership interest.

(b) Borrow from an insurance trust or a family entity, secured by the partnership interest.

(c) There are three options for utilizing partnership funds: redemption, distribution or loan. *Erickson* involved a purchase of assets and redemption but held against the taxpayer. Pro rata distributions are a possibility, but if they are made on an "as needed basis" that plays into the

IRS's hands on the §2036 issue; the estate can argue that distributions for taxes are made all the time from partnerships, but usually for income taxes. John Porter prefers borrowing from the partnership on a bona fide loan, using the partnership interest as collateral. It is best to use a commercial rate rather than the AFR rate (that looks better to the government as an arm's length transaction).

Some attorneys suggest that the preferred approach is to have other family members or family entities purchase some of the decedent's partnership interest to generate cash flow to the estate for paying post-death expenses, so that the necessary cash never comes directly from the partnership.

(4) **Roadmap to Flunking Bona Fide Transfer Requirement.** The reasons given by the court as to why the stated nontax reasons were not significant reasons motivating the creation of the LP provide a roadmap of what to avoid in planning. The court discussed the following eight reasons:

- No discussion of creating the LP until the eve of death;
- No changes in the assets, suggesting that no need for management existed before the LP's creation;
- No financial elder abuse other than what had occurred years earlier;
- No contemporaneous documentary evidence of motivations for creating the LP other than the attorney's reference to "obtaining a deeper discount";
- No pooling of assets for joint enterprise or obvious creation of synergies;
- No business interests requiring active management;
- All transactions by the agent, with the decedent not involved in any planning; and
- A depletion of liquidity to the point that the estate could not pay cash bequests or estate taxes.

(5) **Incorporates Groundbreaking Analysis from Relatively Recent §2036 Cases; *Estate of Powell* and *Estate of Moore*.** The *Estate of Fields* case incorporates the reasoning and approach of several groundbreaking cases in the last several years.

(a) **"In Conjunction With" Section 2036 (a)(2) Argument.** *Estate of Fields* applies the analysis in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), which applied §2036(a)(2) to a situation in which the partners could act unanimously to dissolve the partnership because the decedent could act "in conjunction with others" to designate who could enjoy the partnership assets. Planners have been concerned that the "in conjunction with" analysis could be applied so broadly that any partnership in which a decedent owns any interest could be subject to §2036(a)(2) because all the partners could amend any partnership agreement. But *Estate of Levine v. Commissioner*, 158 T.C. 58 (2022), fortunately held that the mere ability to amend a contract was not sufficient to trigger the "in conjunction with" clause in §2036(a)(2) and §2038. The "alone or in conjunction with" analysis has been the focus of various cases in the last several years following the *Powell* case. For a discussion of *Powell*, *Cahill*, *Morrissette*, and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For further discussion of ways to avoid the *Powell* issue, see Item 28.e below.

(b) **Section 2043 Analysis.** *Estate of Fields* is the first case to repeat and rely on the analysis in *Estate of Moore v. Commissioner*, T.C Memo. 2020-40, of the interaction of §2033, §2036, and §2043. (That analysis of §2043 had been described briefly in *Powell v. Commissioner*.) Under the §2043 analysis, a person may have more estate inclusion by creating an LP than if the person had just retained the assets outright. Under the *Estate of Moore* analysis, the aggregate net value included in the gross estate under §2033, §2036, and §2043 is stated algebraically as V = A+B-C, where:

A is the estate's interest in the partnership (at its date of death discounted value) (included in the gross estate under §2033);

B is the date of death value (undiscounted) of the assets contributed to the LP (included in the gross estate under §2036); and

C is the discounted value of the partnership interest received when assets were contributed to the LP (subtracted under §2043.)

In *Moore*, because the decedent died only 27 days after the partnership was funded and because there was no evidence the asset values changed in that time period, "A" and "C" in the formula cancelled each other out, so the value included in the gross estate was the date of death value of the assets contributed to the partnership (undiscounted).

The effect, compared to not creating the LP and continuing to own all the assets outright, is that extra inclusion may result to the extent the date of death discounted value of the LP interest exceeds the date of funding discounted value of the partnership interest. For a detailed discussion of the §2043 analysis in *Estate of Moore*, see Akers & Aucutt, *Estate of Moore v. Commissioner* Summary (April 2020) available **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(6) **Overview of Prior Cases Addressing Section 2036 Issues.** For an overview discussion of §2036 issues for FLPs and LLCs, including the bona fide sale for full consideration defense and §2036(a)(1) retained interests, see Item 8 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** About 35 reported cases have arisen. The cases seem to be decided largely on a "smell test" basis.

(a) **Section 2036(a)(1).** The IRS typically argues that assets should be included under §2036(a)(1) as a transfer to the FLP/LLC with an implied agreement of retained enjoyment. The most recent case applying §2036(a)(1) to an FLP before *Estate of Fields* was *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40 (April 7, 2020, Judge Holmes), *aff'd*, 128 AFTR 2d 2021-6604, Docket No. 20-73013 (9th Cir. Nov. 8, 2021). (It also had an interesting discussion of the application of §2043, following up on the discussion of §2043 in *Estate of Powell v. Commissioner*, with its own lengthy analysis, and the effect of a formula charitable transfer, which was the only subject of the appeal.) For a detailed discussion of *Estate of Moore*, see Item 20 of Estate Planning Current Developments and Hot Topics (Mar. 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(b) **Section 2036(a)(2).** In a few cases, the IRS has also made a §2036(a)(2) argument, that the decedent has enough control regarding the FLP/LLC to designate who could possess or enjoy the income or property contributed to the entity. Two cases have applied §2036(a)(2) where the decedent had some interest as a general partner (*Strangi* and *Turner*), and one case applied §2036(a)(2) when the decedent held merely a limited partnership interest based on the ability, "in conjunction with others" to dissolve the partnership (*Powell*).

A possible defense to inclusion under §2036(a)(2) may apply if distributions are subject to cognizable limits. *See Estate of Cohen v. Commissioner,* 79 T.C. 1015 (1982), Traditionally, planners have relied on the *Byrum* Supreme Court case for the proposition that investment powers are not subject to §2036(a)(2) (though *Strangi* and *Morrissette* made arguments attempting to distinguish *Byrum*).

Section 2036(a)(2) and the "alone or in conjunction with" analysis has been the focus of several cases in the last several years following the *Powell* case. For a discussion of *Powell*, *Cahill*, *Morrissette*, and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(7) **Summary of §2036 FLP/LLC Cases (14-24, with 2 Cases on Both Sides).** For a summary of the various FLP/LLC cases that the IRS has chosen to litigate under §2036 (up to 2022), see Item 9.f of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(8) **Ramifications.** Ramifications if the IRS is successful in applying §2036 or 2038 to bring all assets of the entity into the estate include: (1) estate inclusion of entity assets may apply even if interests in the entity are transferred during life (*Harper*, *Korby*), (2) the marital or charitable deduction may not be applicable or may be greatly reduced (*Turner*), and (3) double counting of assets included in the gross estate may result (*Powell, Moore,* and *Fields*).

(9) **Overview of Planning Alternatives for Avoiding §2036.** For a listing of planning alternatives for avoiding inclusion under §2036 (and in particular, §2036(a)(2)) in light of *Powell, Cahill*, and *Fields*, see Item 28.e below.

(10) **Bona Fide Sale for Full Consideration Defense.** The bona fide sale for full consideration defense is the best defense to any §2036 attack. Planners should accordingly consider documenting the purposes of transfers to entities at the time of the creation of the entities. John Porter points out that factors that have been applied in finding that a "significant and legitimate non-tax reason" (*Bongard*) existed under a case-by-case for an entity are:

- Centralized asset management (*Stone, Kimbell, Mirowski, Black*)
- Involving next generation in management (*Stone, Mirowski, Murphy*)
- Protection from creditors/failed marriage (*Kimbell, Black, Murphy, Shurtz*)
- Preservation of investment philosophy (*Schutt, Murphy, Miller*)
- Avoiding fractionalization of assets (*Church, Kimbell, Murphy*)
- Avoiding imprudent expenditures by future generations (*Murphy, Black*)

(11) **Investment and Management Decisions for LPs and LLCs.** If the donor serves as a manager of or in some other management position with the entity, the IRS could possibly argue under *Powell* and *Fields* that the donor's authorities "in conjunction with others" could impact beneficial enjoyment of the transferred assets. See Item 28.g(3) below.

(12) **Review of Court Cases Valuing Partnership/LLC Interests.** Despite the many cases that have addressed the applicability of §2036 to limited partnership or LLC interests, fewer cases have actually reached the point of valuing partnership interests. Observe that some cases have allowed discounts even for controlling interests in FLPs or LLCs. *E.g.*, *Estate of Warne v. Commissioner*, T.C. Memo. 2021-17 (4% lack of control discount for controlling majority interests in LLCs); *Estate of Streightoff v. Commissioner*, T.C. Memo. 2018-178, *aff'd*, 954 F.3d 713 (5th Cir. 2020) (18% lack of marketability discount for estate's de facto controlling interest in LLC holding cash and marketable securities). John Porter summarizes discounts that have been allowed by the courts in FLP/LLC cases as follows (some additional cases and explanations have been added to the table):

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
Strangi I (2000)	Securities	Tax	31%
Knight (2000)	Securities/real estate	Tax	15%
Jones (2001)	Real estate	Tax	8%; 44%
Dailey (2001)	Securities	Tax	40%
Adams (2001)	Securities/real estate/minerals	Fed. Dist.	54%
Church (2002)	Securities/real estate	Fed. Dist.	63%
McCord (2003)	Securities/real estate	Tax	32%
Lappo (2003)	Securities/real estate	Tax	35.4%
Peracchio (2003)	Securities	Tax	29.5%
Deputy (2003)	Boat company	Tax	30%
Green (2003)	Bank stock	Tax	46%
Thompson (2004)	Publishing company	Tax	40.5%
Kelley (2005)	Cash	Tax	32%
Temple (2006)	Marketable securities	Fed. Dist.	21.25%
Temple (2006)	Ranch	Fed. Dist.	38%
Temple (2006)	Winery	Fed. Dist.	60%
Astleford (2008)	Real estate	Tax	30% (GP); 36% (LP)
Holman (2008)	Dell stock	Tax	22.5%
Keller (2009)	Securities	Fed. Dist.	47.5%
Murphy (2009)	Securities/real estate	Fed. Dist.	41%
Pierre II (2010)	Securities	Tax	35.6%
Levy (2010)	Undeveloped real estate	Fed. Dist. (jury)	0 (valued at actual sales proceeds with no discount)
Gallagher (2011)	Publishing company	Tax	47%
Koons (2013)	Securities	Tax	7.5%; Estate owned 70.42% of voting interests and could remove limitation on distributions
Richmond (2014)	Marketable securities	Tax	46.5% (37% LOC/LOM & 15% BIG)
Giustina (2016)	Timberland; forestry	Tax	25% with respect to cash flow valuation (Tax Court applied 75% weight to cash flow factor and 25% weight to asset value method); BUT reversed by 9th Circuit and remanded to

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
			reconsider without giving 25% weight to asset value method)
Streightoff (2018)	Securities	Tax	0% lack of control discount because the 88.99% LP interest could remove the general partner and terminate the partnership; 18% lack of marketability discount
Kress (2019)	Manufacturing	Tax	Lack of marketability discounts of 25% for 2007-2008 gifts & 27% for 2009 gifts (those numbers include 3% downward adjustment because a family transfer restriction was not taken into account); additional adjustment for minority interest in non-operating assets
Jones (2019)	Sawmill & timber	Tax	35% lack of marketability discount from value of noncontrolling interest
Grieve (2020)	Securities	Tax	35% for one LLC and 34.5% for another LLC (98.8% non-voting LLC interest)
Nelson (2020)	FLP owned 27% of holding company that owned various subsidiaries with operating businesses	Tax	FLP's interest in holding company valued with 15% lack of control discount and 30% lack of marketability discount (combined 40.5% discount); transferred limited partner interest in FLP valued with 5% lack of control discount and 28% lack of marketability discount (combined 31.6% discount)
Warne (2021)	Majority interests in five LLCs (each over 70%) owning real estate	Tax	Four majority LLC interests not passing to charity: 2% lack of control discount (court might have found no LOC discount but parties agreed some LOC discount was proper) and 5% lack of marketability discount; One wholly owned LLC interest passing to two charities: for charitable deduction, parties stipulated a 4% discount for a 75% LLC interest and 27.385% discount for a 25% LLC interest
Smaldino (2021)	Ten rental real estate properties	Tax	36% combined lack of control and marketability discount (accepting view of IRS expert) for transfers of minority nonvoting interests

Adapted from John Porter, A View from the Front Lines – Current Issues in Estate and Gift Tax Audits and Litigation, 58TH ANN. HECKERLING INST. ON EST. PL. (2024); John Porter, *A View from the Trenches: Current Issues in Estate and Gift Tax Audits and Litigation,* 56TH ANN. HECKERLING INST. ON EST. PL. (2022).

27. Creative Alternative Approach That Might Avoid Section 2036 Attacks on Amounts Contributed to FLPs/LLCs

Consider the following approach, coming from the ever-creative mind of Carlyn McCaffrey (New York, New York). Rather than contributing assets directly to an FLP or LLC, the individual would transfer the assets to an incomplete gift trust that would, for example, give the individual a power to shift benefits from one beneficiary to another or to add or remove beneficiaries, Reg. §25.2511-2(c)). The individual might be included as a discretionary beneficiary. The trustees of the incomplete gift trust, which would not include the individual, might then contribute assets to an FLP or LLC in return for units in the entity. The individual has not made a transfer to and even if she did, she does not own any interest in or hold any control over the assets in the FLP or LLC; it would seem that the individual has not retained any interest or power over the assets of the FLP or LLC that would be subject to taxation under §2036 or §2038. The assets of the incomplete gift trust (i.e., discounted interests in the FLP or LLC) will be included in the gross estate of the individual under either or both of §2036(a)(2) and §2038 because of the retained power that caused the gift to be incomplete, but the assets of the FLP or LLC should not be. The individual is not the owner of the trust under state law principles. (That is to be contrasted with a revocable trust, which might be viewed as being owned by the individual who can revoke it and obtain all its assets.)

Even if the IRS makes a step transaction argument, the individual has never owned or retained anything with respect to the FLP or LLC. Any distributions from the FLP or LLC would pass to the trust, not to the

individual. As discussed above, the individual is not the "owner" of the trust and the trust's interest cannot be attributed as ownership by the individual (unless the individual has "de facto" control over the trustee). (The IRS has had little success in make a de facto control argument. *E.g.*, *McCabe v. United States*, 475 F.2d 1142 (Ct. Cl. 1973) (no estate inclusion even though trustee ignored interests of beneficiaries other than settlor); *Estate of Goodwyn v. Commissioner*, T.C. Memo. 1973-153 (grantor at all times, with the acquiescence of two attorneys serving as trustees, made all decisions regarding the administration of the trust, including distributions; court based its reasoning largely on *Byrum* in which the Supreme Court held that the term "right" as used in §2036(a)(2) refers to "an ascertainable and legally enforceable power").)

The same arguments presumably could be made even for deathbed transfers.

Query whether the IRS might raise a lack of economic substance, substance over form, or sham transaction argument? But unless the IRS could succeed in arguing that the individual really has control over the FLP or LLC under a de facto trustee argument, there really is economic substance to the transaction. The individual is not a recipient of any interest in the FLP or LLC; the trust is, and it is a separate state law entity not owned by the individual.

If the individual is a discretionary beneficiary of the trust, preferably the trust should be sitused in a "domestic asset protection trust" jurisdiction that does not give the individual's creditors access to the trust assets to satisfy the individual's debts merely because she is a discretionary beneficiary. Otherwise, the IRS might make the argument that the individual should be treated as the "owner" of the trust (because the individual could incur debts to be satisfied by the trust). The IRS might attempt (under a step transaction or substance over form argument) to treat the individual's deemed "ownership" of the trust as attributing the trust's contribution to and interest in the FLP or LLC as if the individual had made the contribution to the FLP or LLC while retaining the tax sensitive interest or power.

28. FLP and LLC Planning; Donor Retained Rights and Powers That Trigger §2036(a)(2) Inclusion; Management Rights of LLC; Mere Retention of Majority interest in the Entity Does Not Necessarily Trigger Inclusion

For corporate stock, Rev. Rul. 81-15, issued following the Supreme Court's decision in *U.S. v. Byrum*, 408 U.S. 125 (1972), makes clear that a donor can give nonvoting stock and retain voting stock without risking inclusion of the nonvoting stock in the estate under §2036(b). *Byrum* and Rev. Rul. 81-15 do not apply directly, however, to FLPs or LLCs. For example, shareholders, unlike members of LLCs and members of partnerships, do not typically have the right to vote directly on liquidation. The liquidation of a corporation must first by proposed by the board of directors who have fiduciary obligations to all shareholders. Indeed, the case law developments regarding partnerships and LLCs are more complicated than merely applying concepts from *Byrum* and Rev. Rul. 81-15.

a. **Early IRS Rulings.** The concept of Rev. Rul. 81-15 regarding voting and nonvoting stock was extended to noncorporate entities in a variety of private letter rulings and Technical Advice Memoranda in the 1990s. The rulings dealing with limited partnerships concluded that a senior family member could retain investment and distribution authority over partnership assets as general partner because of the general partner's fiduciary position. *See* Tech. Adv. Memo. 9131006; Letter Rulings 9415007, 9332006, 9131006.

b. ***Strangi* and Its Analysis Distinguishing *Byrum*.** That rather black and white position started to change with *Estate of Strangi v. Commissioner*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005) (not addressing the §2036(a)(2) issue). *Strangi* held that §2036(a)(1) applied to assets contributed to a limited partnership, but surprisingly also held that §2036(a)(2) applied because the decedent, in conjunction with others, had powers over distributions and the power to dissolve the partnership. (The decedent owned 47% of the corporation that was the general partner.)

   The *Strangi* court distinguished *U.S. v. Byrum*, 408 U.S. 125 (1972), which held that the decedent's right to vote shares of stock in three corporations that he had transferred to a trust for the benefit of his children did not cause the value of those shares to be included in the value of his estate under §2036(a)(2). The Court rejected the government's argument that the decedent's ability to vote the

transferred shares gave the decedent the power to impact the corporation's dividend policy and thus the trust's income (or the trust beneficiaries' ability to enjoy the income). The Court noted that the "right" ascribed to the decedent

> was the power to use his majority position and influence over the corporate directors to "regulate the flow of dividends" to the trust. That "right" was neither ascertainable nor legally enforceable and hence was not a right in any normal sense of that term.

Among other things, *Byrum* noted that the decedent, as the controlling shareholder of each corporation, owed fiduciary duties to the minority shareholders that circumscribed his influence over the corporations' dividend policies.

Strangi pointed to various additional constraints upon the "rights to designate" in *Byrum.* These included: (1) the existence of an independent trustee with sole authority to pay or withhold income *Byrum* (in *Strangi*, distribution decisions were made by the general partner); (2) economic and business realities of small businesses that impact earnings and dividends; and (3) fiduciary duties were owed to unrelated minority shareholders in *Byrum*.

c. **Section 2036(a)(2) Cases Prior to *Powell*.** Few cases latched onto the §2036(a)(2) analysis in *Strangi* until recently. Eight years after *Strangi*, *Estate of Turner v. Commissioner*, T.C. Memo. 2011-209, applied §2036(a)(2) in part because of the general partner's sole discretion to make distributions and to make distributions in kind and amend the partnership agreement (decedent and his wife were the co-general partners).

   The §2036(a)(2) issue is infrequently addressed by the courts; it has only been applied with any significant analysis in four prior cases (*Kimbell* and *Mirowski* [holding that §2036(a)(2) did not apply], and *Strangi* and *Turner* [holding that §2036(a)(2) did apply]). In both *Strangi* and *Turner*, the decedent was a general partner (or owned a substantial interest in the corporate general partner).

d. ***Estate of Powell*; Broad Application of "In Conjunction With" Analysis Under §2036(a)(2).** Fourteen years after *Strangi*, the §2036(a)(2) issue was highlighted by the Tax Court in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017) (reviewed opinion). The majority opinion reasoned (1) that the decedent, in conjunction with all the other partners, could dissolve the partnership, and (2) that the decedent, through her son as the GP and as her agent, could control the amount and timing of distributions. The opinion adopted the analysis in *Strangi* as to why the "fiduciary duty" analysis in the *Byrum* case does not apply to avoid inclusion under §2036(a)(2) because any such fiduciary duty in *Powell* is "illusory." *Powell* was the first case to apply §2036(a)(2) when the decedent merely owned a limited partnership interest. (However, the court also looked to the powers of the general partner which the court viewed the decedent as holding in conjunction with her agent who was the general partner.)

   Section 2036(a)(2) and the "alone or in conjunction with" analysis has been a major focus of advisors in the last several years following the *Powell* case. The senior family member's retention of distribution authority as general partner or the ability to act with others to dissolve a partnership or LLC may trigger §2036(a)(2) according to *Powell*. However, that result may not apply regarding partnership interests owned by trusts with an independent trustee who makes decisions about distributions of any amounts received from the partnership or LLC.

   A concern with *Powell*'s "in conjunction with" analysis is that it could be applied broadly to cover almost any transfers to entities if the transferor retains any interest, because all owners could always agree to amend the governing documents in a way that would leave the transferor with tax sensitive powers. Fortunately, the Tax Court acknowledged limits on the broad application of the "in conjunction with" analysis in *Estate of Levine v. Commissioner*, 158 T.C. 58 (2022). That case addressed whether assets in an irrevocable life insurance trust involving a split-dollar arrangement were included in the decedent's gross estate. The court stated that the decedent does not hold a §2036(a)(2) or §2038 power merely because of the ability to amend the split-dollar agreement under general contract law principles. *See also Helvering v. Helmholz*, 296 U.S. 93 (1935) (ability of the settlor of a trust with the consent of its beneficiaries to terminate the trust and revest the transferred

property in the donor did not cause estate inclusion under §2036(a)(2) or §2038); *Estate of Tully v. United States*, 528 F.2d 1401 (Ct. Cl. 1976) (ability of decedent and the other 50% shareholder to cause a corporation to agree with the decedent to change the beneficiary under a death benefit contract did not trigger estate inclusion under 2036 or §2038). For a discussion of *Powell* and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

e. **Overview of Planning Alternatives Following *Powell*.** Planning alternatives for avoiding inclusion under §2036 (and in particular, §2036(a)(2) in light of *Powell* include the following:

- No revocable transfers;
- Avoid transfers under a power of attorney;
- Satisfy the bona fide sale for full consideration exception;
- Transfer all voting rights, including power to amend or revoke the agreement;
- Eliminate unanimous partner approval requirement for dissolution (which was present in *Powell* and *Fields*);
- Avoid having the decedent or decedent's agent as general partner of an FLP;
- If the decedent will have some input into distribution decisions, apply "cognizable limits on the exercise of discretion," see *Estate of Cohen v. Commissioner*, 79 T.C. 1015 (1982);
- Provide for slicing and dicing of voting rights and manager powers (discussed in more detail below);
- If the client insists on retaining as much control as possible, for corporations give non-voting stock while keeping the voting stock. *See* Rev. Rul. 81-15, 1981-1 C.B. 457 (revoking Rev. Rul. 67-54, which had held that transferring nonvoting stock, while retaining voting stock, would result in the transferred nonvoting stock being included in the estate under §2036(a)(2));
- For noncorporate entities, cases such as *Strangi*, *Powell,* and *Fields* suggest that the ability to control distributions or to cause dissolution of the entity (or make amendments to the entity agreement regarding those issues) may trigger estate inclusion; for clients who want to keep as much control as possible, the planner may want to start with the client having control of investment and possibly distribution decisions for entities owned by the trust, but eventually give up control over distribution decisions (more than three years before death);
- No participation in removal of managers unless replacement must be not related or subordinate to the donor;
- Use trusts as owners of entity interests with an independent trustee;
- Transfer all interests during life; and
- "Claim victory" and dissolve the FLP/LLC following prior successful transfers.

If the donor retains any voting rights, the planner would be wise to create classes of voting rights. For example, Class A limited partners and members would possess full voting rights normally provided to limited partners or members, and Class B limited partners or members (including the donor) could vote on all matters other than (a) the liquidation or dissolution of the entity, (b) distributions from the entity, (c) the right to approve a proposed transfer of an interest in the entity, or (d) the amendment of the entity agreement in a way that would alter any of those restrictions.

For a more detailed discussion of these and other planning steps in light of *Powell*, see Item 19.d. of Estate Planning Current Developments and Hot Topics (December 2020) found **here**, Item 15.g. of the Current Developments and Hot Topics Summary (December 2017) found **here**, and Item 8.c-e of

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

f. **Transfers While Retaining Interests in the Partnership or LLC (Even Majority Interest).** The fact that the senior family member also retains some interest in the partnership or LLC (or even a majority interest) should not necessarily require estate inclusion under §2036(a)(2). What is problematic is the ability, alone or in conjunction with others, to control distributions or to cause dissolution of the entity (or make amendments to the entity agreement regarding those issues). Several courts have attributed powers held by an agent to the principal, so avoid having any of those problematic powers held by either the transferor or the transferor's agent.

g. **Planning Considerations for Clients Who Want to Keep Some Investment or Distribution Powers as Manager of LLC or as General Partner of Limited Partnership.**

(1) **Relinquish Control More Than Three Years Prior to Death.** For the client who insists on retaining broad control of investments and possibly distribution decisions for entities owned by the trust, eventually give up control over distribution decisions and tax sensitive investment decisions (see Item 28.g(3) below) more than three years before death to avoid §2035(a).

(2) **Distribution Decisions.** If the donor will continue to (i) be a general partner, (ii) hold an interest in a general partner, or (iii) be the manager of an LLC, limit the donor from having the right to participate in any distribution decisions. For example, use a separate "distribution general partner" or "distribution manager" who has exclusive authority over decisions about when the entity may make distributions to its owners.

If the donor insists on participating in distribution decisions, §2036 and §2038 should not apply if distributions decisions are subject to a definite standard that is specific enough that it can be enforced by a court (based on old cases under §2036 and §2038). Consider providing that Class A limited partners or a "special general partner" or "special manager" (other than the donor) must consent to establishing reasonable reserves (at least for more than a baseline established in a budget that is approved from time to time by all the partners).

(3) **Investment and Management Decisions.** There are strong arguments that investment and administrative powers held by the donor as a general partner (or manager of an LLC) should not trigger estate inclusion under §2036 or §2038. Citations of various cases are in Item 9.d(2) of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

Even if the interest in the entity is owned by a trust with an independent trustee, if the donor serves as a manager of or in some other management position with the entity, the IRS could possibly argue under *Powell* that the donor's authorities "in conjunction with others" could impact beneficial enjoyment of the transferred assets.

Because of these concerns, if the donor makes a gift of an interest in the entity, some respected planners structure the entity to avoid having the donor as a general partner or manager or limit the donor's authority as manager or other management position to participate in "tax-sensitive" activities. Diana Zeydel (Miami, Florida) has noted the possibility of limiting the donor's authority as manager with respect to decisions, approvals, or consents relating to various potentially tax sensitive activities such as distributions, allocations to reserves, determining the fair market value of interests, making loans to or guarantees of loans of any entity owner, withdrawal or resignation of any owner, dissolution or liquidation of the entity, any incident of ownership in any life insurance policy on the life of any entity owner, voting the stock of any "controlled corporation" as described in §2036(b), or an amendment of the governing instruments with respect to any of those matters.

If the donor merely makes a sale of an interest in an entity (and does not make a gift), planners may still encourage the appointment of a distribution officer and a liquidation officer to be safe and let the donor just manage the assets.

Other respected planners are not as concerned with the donor serving as the manager of an LLC with authority over LLC investments, especially if the owners of the entity are family trusts with independent trustees. They believe that only the independent trustee of the trust can control the beneficiary's enjoyment of the gifted asset, and the LLC manager has a fiduciary duty to the LLC members a la the Supreme Court's fiduciary duty analysis in *United States v. Byrum*; therefore, it is the trustee of the trust and not the grantor as manager who controls the income and distribution spigot to the recipients of the gifted property.

29. Distribution of Insider Stock to Satisfy GRAT Annuity Payment Is Not a "Purchase" Under the Section 16(b) Short-Swing Profits Rule If the Insider is the Grantor, Trustee, and Annuitant of the GRAT; No Mention of Existence of Swap Power in Final Order Dismissing the Case, *Nosirrah Management, LLC v. AutoZone, Inc.*, (W.D. Tenn. April 14, 2025)

a. **Case Synopsis.** William Rhodes III (Defendant) created a GRAT that gave him a power of substitution for fair consideration (generally referred to as a swap power). The plaintiff alleged that Defendant was a company insider who received distributions of AutoZone, Inc. stock from the GRAT in satisfaction of a required annuity payment and subsequently sold AutoZone stock within six months for a profit, so the profit should be disgorged under Section 16(b) of the Securities Exchange Act of 1934. A difficulty with plaintiff's argument is that a prior SEC No-Action Letter (*Peter J. Kight* SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 77,403 (Oct. 16, 1997)) ruled that the creation of a GRAT and subsequent return of stock to the settlor in satisfaction of annuity payments satisfied the Rule 16a-13 Exemption for a transaction "that effects only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities" and therefore was not a "purchase" under Section 16(b) where the individual was the settlor, trustee, and beneficiary. Defendant filed a motion to dismiss arguing that he was the settlor, trustee, and beneficiary of the GRAT and should therefore satisfy the "mere change of form and no change in pecuniary interest" exemption as in the *Peter J. Kight* SEC No Action Letter. The plaintiff responded that a distinction was that the Defendant held a swap power, and it is not clear whether the individual in the *Peter J. Kight* SEC No-Action Letter also held a swap power.

In an Order issued on November 15, 2024 (the 2024 Order), the court denied the motion to dismiss, reasoning that the Defendant had not submitted evidence that he was the settlor, trustee, and beneficiary, and therefore could not establish that the "mere change of form and no change in pecuniary interest" exemption applied. However, the 2024 Order also had language suggesting that the exemption might not apply because of the mere existence of the swap power in the GRAT, even if the swap power was not exercised, and could somehow cause the distribution in satisfaction of the annuity to become a purchase that could trigger the short-swing profits rule. The 2024 Order was problematic for planners because most planners have assumed that the mere existence of a swap power (without exercising it) would not cause a GRAT annuity distribution to a settlor, trustee, and beneficiary to be a "purchase" under Section 16(b).

Following the submission of evidence that the court said was lacking in the 2024 Order, the court entered an Order on April 14, 2025 (the 2025 Order), granting in part and denying in part motions for summary judgment by the plaintiff and defendant, with the result that the case was dismissed. The court determined that the plaintiff had standing to bring the action but determined that the distributions of stock in satisfaction of the GRAT annuity payments satisfied the "mere change of form and no change in pecuniary interest" exemption for what constitutes a "purchase" under Section 16(b) where the individual was the settlor, trustee, and annuitant. The 2025 Order includes a detailed analysis of each of the "no change of pecuniary interest" and "mere change of form of beneficial ownership" elements of the exemption. The 2025 Order has absolutely no mention whatsoever of the existence of the swap power in the GRAT instrument, which ameliorates concerns the 2024 Order created regarding the inclusion of a swap power in a GRAT for an insider. Furthermore, it is very positive news; it is a court Order, rather than just an SEC No-Action letter, to support the application of the "mere change of form and no change in pecuniary interest" exemption to distributions of insider stock in satisfaction of GRAT annuity payments.

Nosirrah Management, LLC v. AutoZone, Inc., Case No. 2:24-cv-2167 (W.D. Tenn. April 14, 2025).

b. **General Background Regarding Effect of Section 16(b) Short-Swing Profits Rule on GRAT Planning.** Section 16(b) of the Securities Exchange Act of 1934 permits recovery by a corporation of insider trading profits made within a 6-month period. Liability under Section 16(b) requires proof of (1) a purchase and (2) a sale of securities (3) by an officer or director of the issuer or by a shareholder who owns more than ten percent of any one class of the issuer's securities (4) within a six-month period. An exemption under Rule 16a-13 states that "[a] transaction … that effects only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject securities shall be exempt from [Section 16(b)]."

Section 16(b) may apply in the context of GRATs in several different situations. A contribution to a GRAT is arguably a "sale," and a distribution of insider stock in satisfaction of the annuity payment is arguably a "purchase" by the grantor. If a corporate insider funds a GRAT with the corporation's stock, will the return of some of the stock to the grantor (in satisfaction of an annuity payment) trigger a 6-month insider trading test period? A 1997 SEC No-Action Letter held that the creation of a GRAT and subsequent return of stock to the grantor in satisfaction of annuity payments will "effect only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities." Mr. Kight was the settlor, trustee, and beneficiary of the GRAT during the annuity period of the GRAT. Accordingly, such a transaction would be ignored for §16(b) purposes under that No-Action Letter. *Peter J. Kight*, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 77,403 (Oct. 16, 1997).

A Section 16(b) liability issue could also arise if a GRAT distributes insider stock to the insider-annuitant and the insider sells stock within 6 months. Plaintiff in *AutoZone* alleges that the distribution of stock from the GRAT in satisfaction of a required annuity payment was a "purchase" by the insider, and that the insider sold stock within six months of that purchase at a profit, and therefore, the profit must be disgorged. The issue is whether the distributions of stock in satisfaction of the annuity payments are "purchases" under Section 16(b) or whether they are exempt transactions.

Several cases have addressed exercises of swap powers in this context. If the grantor/corporate insider **exercises** a power to substitute property of equal value for some of the stock in a GRAT during its term, one court held that the substitution constitutes a "purchase" for §16(b) purposes, thus creating a six-month period during which any profits from subsequent sales of such stock would have to be disgorged to the corporation. *Morales v. Quintiles Transnational Corp.*, 25 F. Supp. 2d 369 (S.D. N.Y. 1998). The case was appealed to the Second Circuit Court of Appeals, but was settled prior to hearing, and the appeal was withdrawn.

In *Donoghue v. Smith*, 2022 U.S. Dist. LEXIS 76071; 2022 WL 1225338 (S.D. N.Y. April 26, 2022), a company insider created a GRAT, exercised a swap power to acquire company stock, and sold company stock within six months. The insider was not the trustee or beneficiary of the GRAT (perhaps the annuity term had ended). The "mere change of form and no change in pecuniary interest" exemption did not apply, and the insider was forced to disgorge the profits on the short-swing sale.

In *Dreiling v. Kellett*, 281 F. Supp. 2d 1215, 1244 (W.D. Wash. 2003), the court imposed a $247 million damage award, as a result of determining that distributions from a GRAT constituted a "sale." *See generally* Ellen Harrison, *Case Studies – Implementing Bright Ideas*, 38th ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING ¶1902.5 (2004).

No prior case has held that the **mere existence** of a swap power would cause the "mere change of form and no change in pecuniary interest" exemption not to apply.

c. **2024 Order – Evidentiary Issue.** The court entered an order dated November 15, 2024 (the "2024 Order") refusing to dismiss the action. The primary rationale of the court seemed to be the absence

of evidence in the proceeding up to that point that the insider was the trustee and beneficiary of the GRAT.

> [T]the Court considers Defendant's citation to the Complaint and finds it does not support his statement regarding his grantor, trustee, and beneficiary status. … There is … no support in the Complaint regarding Defendant's trustee or beneficiary status.
>
> Nor is Defendant's statement regarding his trustee or beneficiary status supported by any exhibits, public records, or other attachments.
>
> …
>
> … Defendant did not provide any proof of his trustee or beneficiary status. Defendant's argument regarding his pecuniary interest status, a key element of the Rule 16a-13 exemption … relies on his trustee and beneficiary status.
>
> …
>
> However, Defendant cannot show he had a pecuniary interest in the AutoZone stock when it was in the GRATs, as his statement regarding his trustee and beneficiary status cannot be considered.
>
> …
>
> Defendant's beneficial ownership argument fails for the same reason as its pecuniary interest argument-it is based on his status as the "grantor, trustee, and sole lifetime beneficiary of the GRATs."

d. **2024 Order – Mere Existence of Swap Power.** There is also language in the opinion suggesting that the mere existence of the swap power somehow also causes the exemption not to apply. In its attempt to distinguish the *Peter J. Kight* SEC No Action Letter, the court stated:

> Here, however, "the 'opportunity' existed for [Defendant] to abuse inside information by substituting property of equal value to get the GRAT shares back just before the shares appreciated drastically," *[quoting Morales v. Quintiles Transnat'l Corp.)*, because there is a reasonable inference that Defendant could exercise his discretion by substituting the stock in the GRATs with other property of equal value.

In distinguishing *Morales* (which involved the actual exercise of a substitution power and subsequent sale of stock within six months), the court noted:

> Defendant is mistaken, as the *Quintiles* court based its conclusion on the opportunity to exercise substitution, not the exercising of substitution itself: "Therefore, the 'opportunity' existed for Smith to abuse inside information by substituting property of equal value to get the GRAT shares back just before the shares appreciated drastically. The Kight letter is therefore inapplicable here." (quoting the *Morales* opinion)

Those were rather short references to the mere existence of the swap power, compared to the much more lengthy discussion in the Order about the lack of evidentiary evidence to establish the applicability of the exemption.

e. **Significance of 2024 Order for GRAT Planning.** The 2024 Order is merely the denial of Defendant's motion to dismiss the case at an early stage of the proceeding, and the decision is primarily based on the lack of evidence that had been produced up to that point in the proceeding about whether the Defendant was trustee and (more importantly) the sole beneficiary of the GRAT during the period of the annuity term. Furthermore, treating the mere existence of a swap power as somehow constituting a "purchase" is not well reasoned. The 2025 Heckerling Recent Developments paper makes this observation: "Carlyn McCaffrey notes that the gist of the Rule 16a-13 exemption is that an insider's economic position has not changed when the insider is the sole beneficiary of the GRAT and stock is used to satisfy the insider's annuity interest. A power of substitution would not have any bearing on this central question."

Even so, in planning a GRAT for a company insider, the 2014 Order suggests that a planner might consider using powers other than a swap power to confer grantor trust status on a GRAT.

f. **2025 Order Dismissing Case – Applying Exemption and Making No Mention of Swap Power.** The court entered an Order April 14, 2025 (the "2025 Order"), granting in part and denying in part motions for summary judgment submitted by each of the parties and dismissing the case.

(1) **Standing.** Plaintiff Nosirrah Management, LLC brought this derivative action on behalf of the company that issued the stock pursuing disgorgement of the profits from short-swing trading by the defendant. The court determined that the plaintiff has constitutional standing to bring the suit, relying in large part on *Packer ex rel 1-800-Flowers Com. Inc. v. Raging Cap. Mgmt., LLC*, 105 F.4th 46, 53 (2d Cir. 2024), *cert denied* (U.S. 2024). In *Packer*, a shareholder brought a derivative suit on behalf of the issuer of the securities, and the court reasoned that Section 16(b) imposed a "fiduciary duty" on corporate insiders and "confer[red] on securities issuers 'an enforceable legal right to expect [the fiduciary] to refrain from engaging in any short-swing trading." The deprivation of this "enforceable legal right" inflicts an injury sufficiently concrete to confer standing.

(2) **Exemption – Pecuniary Interest Analysis.** The insider had an indirect pecuniary interest in the AutoZone stock when it was held in the GRATs because he "had the indirect opportunity to profit from AutoZone stock through his annuity payments." When securities were distributed to the insider in satisfaction of annuity payments, the insider "maintained a pecuniary interest in the securities, even as it shifted from an indirect to direct pecuniary interest." While the insider did not have the same pecuniary interest in the stock while in the trust and after it had been distributed in payment of the annuity, "[t]he form of the pecuniary interest is not important, as long as the pecuniary interest itself is not extinguished." The exemption refers to a change "in the form of beneficial ownership … but not in the form of the pecuniary interest."

(3) **Exemption – Beneficial Ownership Analysis.** The insider had an indirect pecuniary interest in the AutoZone stock when it was in the GRATs, and after he required the stock in annuity payments he became a direct beneficial owner. He continued his beneficial ownership throughout, and after reacquisition of stock in annuity payments, "his beneficial ownership changed in form from indirect to direct." His children as remainder beneficiaries of the GRATs had no "power to exercise or share investment control over the GRATs … [and] did not have beneficial ownership over the AutoZone stock."

(4) **Conclusion.** The reacquisition of stock in annuity payments effected "only a change in the form of beneficial worship without changing [Defendant's] pecuniary interest in the subject equity securities" and is exempted from being a "purchase" of securities under Section 16(b). The court dismissed the action with prejudice.

(5) **No Mention of SWAP Power.** The 2014 Order had suggested that the mere existence of the swap power in the trust agreement, even if not exercised, could somehow treat the insider as having "purchased" stock because of the ability to exercise the power when desired. The court's final Order makes no mention whatsoever of the swap power in the GRAT.

g. **Turnaround.** The 2024 Order was very concerning for planners advising insiders who create GRAT with the insider's stock. It suggested that the GRAT should not include a substitution power as a way of assuring that the trust is a grantor trust because of the offhand comment in the Order (that was not central to the reason for denying the motion for summary judgment at that stage of the case). The 2025 Order dismissing the case does not even mention the swap power, ameliorating the concern of most planners about using swap powers in GRATs for insiders. To the contrary, the case is now very positive news; it is a court order, rather than just an SEC No-Action letter, to support the application of the "mere change of form and no change in pecuniary interest" exemption to distributions of insider stock in satisfaction of GRAT annuity payments as not constituting "purchases" under Section 16(b).

h. **Use of LLC as a Possible Planning Alternative.** A planning possibility to minimize the risk of a Section 16(b) action is to transfer company stock to an LLC and to transfer interests in the LLC to the GRAT. While the transfer to the LLC would be reportable to the SEC, perhaps the transfer of member interests to the GRAT and from the GRAT as annuity payments would not be reportable.

i. **Other Resources.** For further discussion of the securities laws implications for GRAT planning see Item 25 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found

here and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For excellent discussions of securities law issues impacting estate planning issues, see Anna Pinedo, Jay Waxenberg, Daniel Hatten, *Securities Law Considerations for Estate Planners*, 48 ESTATE PLANNING 3 (Nov. 2021); Arlene Osterhoudt & Ivan Taback, *Securities Law Considerations for Estates and Estates Advisors: Part I (Accredited Investors and Qualified Purchasers),* TRUSTS & ESTATES 19 (July 2016); Arlene Osterhoudt & Ivan Taback, *Securities Law Considerations for Estates and Estates Advisors: Part II (Reporting and Short-Swing Profit Rules Applicable to Insiders)*, TRUSTS & ESTATES 24 (Mar. 2017).

30. Estate Planning Issues for Real Estate Investors and Developers

Comments in this item are from an excellent presentation by Farhad Aghdami (Richmond, Virginia) and a panel discussion by Farhad and Gray Edmondson (Oxford, Mississippi) at the 59th Heckerling Institute on Estate Planning. Their presentation was an outstanding summary of issues particularly (and sometimes uniquely) important for real estate investors (referred to in this Item as "RE investors").

a. **Overview of Important Income Tax Issues.** These issues are also discussed below, but as an overview, RE investors have unique issues and concerns with estate planning transfers.

   (1) **Debt in Excess of Basis or Negative Capital Accounts.** The investor may have debt in excess of basis (because of accelerated depreciation) or may have negative capital (because of refinancings), and transfers could result in gain recognition (other than transfers to grantor trusts).

   (2) **Real Estate Professional.** If the investor qualifies as a real estate professional, real estate losses can be deducted, not limited by the passive loss rules, meaning that the real estate investor may have little or no income tax.

   (3) **Roth IRA Conversions.** Because of large losses, the real estate investor may be able to convert regular IRAs to Roth IRAs. RE investors often have very large Roth IRAs.

b. **Balance Sheet.** The balance sheet is very important to the RE investor to reduce borrowing costs and to qualify for bonding.

   (1) **Balance Sheet vs. Estate Planning Tension.** The RE investor will want to have a large balance sheet for important operating purposes but that may be contrary to estate planning goals (listing assets at appropriate discounted values, etc.)

   (2) **SLATs.** The RE investor will be tempted to include assets in the spouse's SLAT on the investor's balance sheet. One option is to list the income from the SLAT that could be distributed to the spouse in household income, but the investor should not go further than that.

c. **Hurdles to Transfers.**

   (1) **Out of Attorney's Control.** Many of the transfer hurdles for RE investors will be out of the attorney's control (whether lenders or partners will consent to transfers, timing of and cost of appraisals, etc.).

   (2) **Lender Concerns.** Transfers will result in a smaller balance sheet, creating lender concern. Also, lenders will push for the RE investor to keep control of operational activities following the transfer, which can at least raise potential issues with avoiding estate inclusion under §2036(a)(2) and §2038. The failure to obtain necessary consents could result in losing a favorable existing low-interest loan. Obtaining consents from multiple lenders or for HUD loans can be especially tedious.

d. **Guarantees.** Lenders may want personal guarantees from the RE investor, especially for non-recourse loans (commonly referred to as "bad boy guarantees" in connection with non-recourse loans). Be careful with having the investor's spouse also give guarantees.

e. **Asset Protection for Spouse.** Titling real estate as a tenancy by the entireties may protect assets from creditors of just one of the spouses.

f. **Lack of Diversification.** RE investors are typically very highly concentrated in real estate investments. The investor may cross collateralize deals, creating a risk of falling dominos in the case of a reversal.

The concentration may open possibilities of market absorption valuation discounts when interests are transferred.

g. **Manner in Which Real Estate Investments Are Held.** Each separate real estate investment is typically held in a separate LLC. All investments will often be managed by a management company, of which the investor is the manager. The separate investments pay a management fee to the management company. Outside investors may also own interests in the separate LLCs. All the owners may be required to give personal guarantees. An alternative approach is using a single real estate investment fund (having outside investors) with multiple projects in the fund. The fund would be controlled by a general partner.

h. **Specific Issues for RE Investors That Impact Estate Planning.**

(1) **Leveraged Assets.** Only the net value of leveraged assets is included in the estate value.

(2) **Cash Flow.** Cash flow (for making note payments following sales to grantor trusts) will be impacted by outside debt and required payments to lenders.

(3) **Accelerated Depreciation.** Accelerated depreciation is often permitted for particular assets connected with real estate investments, which can result in the assets having a relatively low basis and can even result in having debt in excess of basis. A later sale may result in depreciation recapture.

(4) **Realization on Transfers.** Refinancings (to borrow money against one deal to provide liquidity to fund other deals) can result in negative basis. Transfers of interests with negative basis or debt in excess of basis may result in income realization (but not if made to a grantor trust).

(5) **Timing Issues.** Timing transfers can be especially important in some real estate transactions. For example, if transfers are made before rezoning has been approved, the valuation may be considerably lower.

(6) **Tax Credits.** Real estate investments may qualify for tax credits (for example, historic property, new markets, low-income housing). Special holding periods may apply to avoid recapture of the credits upon transfer.

(7) **Qualified Opportunity Zone Investment.** These investments were popular in 2018 and 2019. Investments in specified zones allowed two tax benefits: (1) recognition of gain on assets that were sold to be reinvested in the qualified opportunity zone (QOZ) asset would be deferred until January 1, 2026 unless a transfer is made triggering an "inclusion event"; and (2) gain on the QOZ investment will not be recognized when the investment is sold (even if there has been accelerated depreciation) if it is held at least 10 years.

Regulations provide that a transfer to a spouse is an inclusion event (despite §1041), but a transfer to a grantor trust is not an inclusion event. Death is not an inclusion event and a transfer from the estate to a beneficiary is not an inclusion event. (Whether that exception applies to QOZ investments held in a revocable trust even if the trust elects to be treated as part of the probate estate for income tax purposes is unclear.) A transfer from the estate to a trust is not an inclusion event, but a subsequent transfer from that trust to a beneficiary or to another trust is an inclusion event. (An inclusion event merely triggers the deferred gain prior to January 1, 2026; it does not impact the 10-year rule.)

i. **Grantor Trust Planning.**

(1) **No Gain Recognition on Transfer to Grantor Trust.** A transfer to a grantor trust is not a gain recognition event, even if the transferred assets have debt in excess of basis or have a negative capital account.

(2) **Investor Considered Owner of the Trust for Income Tax Purposes; Real Estate Professional; Material Participation.** The trust can rely on the investor's activities to qualify as a real estate professional, to satisfy material participation requirements (which is important in meeting the real estate professional test as well as the passive versus active rental activity test of 469(c)(1)), and thereby continue to benefit from tax losses generated by the property.

(3) **IRS Guidance Impacting Tax Treatment of Grantor Trusts.**

(a) Notice 2007-73 ("toggling" as a transaction of interest)

(b) Rev. Rul. 2004-64 (grantor's payment of income tax liability of grantor trust not a gift)

(c) Rev. Rul. 2007-13 (grantor trust transactions with insurance policies (where the grantor is the insured) do not trigger transfer for value rules)

(d) Rev. Rul. 2008-22 (substitution power does not cause estate inclusion under §2036 or §2038)

(e) Rev. Rul. 2011-28 (substitution power over life insurance policy does not cause estate inclusion under §2042)

(f) Rev. Rul. 2023-2 (basis of irrevocable trust assets not in gross estate are not adjusted to fair market value on termination of grantor trust status at the death of the grantor)

(g) CCA 202352018 (modification of grantor trust to add discretionary reimbursement clause is considered a gift by the trust beneficiaries)

(4) **Termination of Grantor Trust Status.** The grantor may wish to terminate the grantor trust status of the trust so the grantor is not liable for the tax on trust income (sometimes referred to as the grantor's "phantom" income tax).

(a) **Mechanics of Terminating Grantor Trust Status.** Planning alternatives include structuring the trust to give the grantor or someone else the flexibility to toggle off grantor trust status, structuring automatic expiration of grantor trust status in some circumstances, including powers of appointment giving a holder the power to appoint the assets to a non-grantor trust, or decanting to a non-grantor trust. Terminating grantor trust status may be difficult (if not impossible) with a SLAT if the spouse continues as a discretionary beneficiary, even if the spouse has become an ex-spouse by way of a divorce.

(b) **Ways of Addressing the Concern Over "Phantom" Income Tax.** Planning alternatives include selling additional assets to the trust so note payments to the grantor can resume, which the grantor can use to pay the income tax; swapping other assets into the trust that generate less taxable income; making loans to the grantor from the trust to pay the tax; structuring automatic expiration of grantor trust status in some circumstances; structuring the trust to give the grantor or someone the flexibility to toggle off grantor trust status; making distributions to the grantor's spouse if the spouse is named as beneficiary; having the grantor retain sufficient assets to pay the income tax; or giving the trustee the flexibility to reimburse the grantor for such income taxes (but possible adverse transfer tax consequences with tax reimbursement must be navigated carefully); including powers of appointment giving a holder the power to appoint the assets to a nongrantor trust; or decanting to a nongrantor trust. These alternatives (and more) are discussed in Kristen A. Curatolo & Jennifer E. Smith, *Strategies for Mitigating the 'Burn' of Grantor Trust Status*, 48 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. No. 3 (May 11, 2023). *See also* Jerome M. Hesch & Paul Lee, *The Financial Danger of Maximizing Taxable Gifts*, LEIMBERG ESTATE PLANNING NEWSLETTER #2035 (Dec. 5, 2012).

(c) **Tax Treatment of Terminating Grantor Trust Status During Grantor's Life.** The conversion of a grantor trust to a non-grantor trust during the grantor's life is treated as a deemed transfer of the assets in the trust to the non-grantor trust at the time of the conversion. *See Madorin v. Commissioner*, 84 T.C. 667 (1985); Reg. §1.1001-2(c), Ex.(5); Rev.

Rul. 77-402. For example, if a partnership interest owned by the trust has a negative capital account at that time, the deemed transfer results in a recognized gain.

(d) **Coordinate With Investor's Accountant Before Terminating Grantor Trust Status During Life.** Coordinate with the investor's tax accountant before terminating the grantor trust status of the trust during life so the investor will be aware of adverse income tax consequences (if there is debt in excess of basis or negative capital accounts or if the trust would lose real estate professional or material participation status).

(e) **Termination of Grantor Trust Status at Death.** The grantor trust status of the trust will automatically terminate at the grantor's death.

i. **Position That Gain Is Not Recognized at Death.** Most planners take the position that the grantor is deemed to make a testamentary transfer at death that does not constitute a gain recognition event under §1001. *See Crane v. Commissioner*, 331 U.S. 1 (1947) (apartment building encumbered by nonrecourse indebtedness equal to the estate tax value of the building passed to surviving spouse; spouse's basis was adjusted to the building's fair market value unreduced by the indebtedness, as property acquired from a decedent, so the disposition of the building to the spouse at the decedent's death was not a taxable event); Rev. Rul. 73-183 (transfer of securities to decedent's estate at death did not generate a loss on the decedent's final income tax return; "the mere passing of property to an executor or administrator on the death of the decedent does not constitute a taxable realization of income" within the meaning of §1001(a)); CCA 200923024 (statement in dicta that "a transfer caused by the death of the owner … is generally not treated as an income tax event); Conference Committee Report to Economic Growth and Tax Relief Reconciliation Act (2001) (in explaining the carryover basis rule in 2010 when there was no estate tax, the report states "The bill clarifies that gain is not recognized at the time of death when the estate or heir acquires from the decedent property subject to a liability that is greater than the decedent's basis in the property").

ii. **Position That Gain Is Recognized at Death.** A minority of planners takes the position that the grantor's death triggers a taxable event as to the grantor trust citing *Madorin v. Commissioner*, 84 T.C. 667 (1985). As discussed above, the termination of grantor trust status during life is treated as a transfer from the grantor to the newly-formed non-grantor trust, which can result in taxable gain. *See also* Reg. §1.1001-2(c) Ex.(5). Paul Lee's presentation at the 2025 Heckerling Institute discussed reasons supporting this minority view. But most planners limit the *Madorin* rationale to a lifetime termination of grantor trust status.

iii. **No Basis Adjustment of Grantor Trust Assets at Grantor Death If Assets Are Not in Grantor's Gross Estate.** Rev. Rul. 2023-2 states that no basis adjustment is allowed under §1014 at the grantor's death for assets gifted to the trust that are not included in the grantor's gross estate. (Rev. Rul 2023-2 does not apply to a trust for which a note exists between the trust and the grantor that has liabilities in excess of basis.) For a detailed discussion of Rev. Rul. 2023-2, see Item 6.c of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The grantor may exercise a substitution power prior to death to substitute high-basis assets into the grantor trust in return for the trust's low-basis assets, which would be owned by the grantor at death and receive a basis adjustment under §1014.

(5) **Sales to Grantor Trusts; Defined Value Clauses; Reporting on Gift Tax Return.** Sales from grantors to grantor trusts are routinely used as an estate freezing alternative. Traditionally, the trust initially has assets prior to the sale that represent at least 10% of the gross value of the trust assets after the sale (i.e., the debt-equity ratio does not exceed 9-1).

(a) **Model Cash Flow.** The anticipated cash flow must be modeled to determine the ability to pay lenders and to make note payments on the sale. The entire cash flow from the business should not be used to make note payments; that could raise a §2036(a)(1) concern that the sale was impliedly a transfer with retention of the income from the transferred asset.

Having sufficient cash flow to pay lenders and to make note payments (both with higher interest rates than previously) may be more difficult than in the past when rates were much lower.

(b) **Disregarded Entity Valuation Principles.** If the interest that is sold is a member interest in an LLC that is owned entirely by the parent and grantor trusts, it may be treated as a disregarded entity for income tax purposes. Even though the entity is "disregarded" for income tax purposes, property rights associated with the interest are still controlled by state law and are valued as such (i.e., with discounts). *See Pierre v. Commissioner*, 133 T.C. 24 (2009) (with a strong dissent).

(c) **Defined Value Clauses.** Defined value clauses may be used for the sale, to minimize the risk of gift liability as a result of selling at a price the IRS and court eventually determine to be less than fair market value.

A combined *Wandry*/consideration adjustment approach could be used (sometimes referred to as a two-tiered *Wandry* transfer). The client would make a traditional *Wandry* transfer of that number of units of the real estate investment that is anticipated to be worth the desired transfer amount (which could either be a gift or a sale), but with a provision that if those units are finally determined for federal gift tax purposes to be worth a higher value, the shares that were not transferred because of the *Wandry* provision would be sold for a note as of the same date as the *Wandry* gift, with the price being determined by the finally determined gift tax value. *See* Joy Matak, Steven Gorin & Martin Shenkman, *2020 Planning Means a Busy 2021 Gift Tax Return Season*, LEIMBERG ESTATE PLANNING NEWSLETTER Archive #2858 (Feb. 2, 2021) (includes excellent suggested detailed disclosures for reporting a two-tiered *Wandry* transfer on a gift tax return and income tax return, including Schedule K-1 disclosures).

For a more detailed overview of the use of defined value clauses, see Item 12 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(d) **Reporting on Gift Tax Return.** Sales can be reported on a gift tax return to start the running of the traditional 3-year statute of limitations on additional gift tax assessments. The adequate disclosure regulations have detailed requirements that should be satisfied to assure that the disclosure is sufficient to start the running of the limitations period. Reg. §301.6501(c)-1(f).

In particular, watch out for these points regarding discounts: (1) the donor must affirmatively answer "Yes" to the Question A on Schedule A asking if a discount is being claimed; and (2) the amount of the discount and the basis for applying the discount must be described.

The Tax Court determined that "substantial compliance" with those requirements is sufficient. *Schlapfer v. Commissioner*, T.C. Memo. 2023-65 (2023). However, careful planners will follow the regulatory requirements as closely as possible. For a discussion of *Schlapfer* and planning with the adequate disclosure rules, see Item 14 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(6) **SLATs.** A RE investor may consider making the gift to a trust of which the spouse is a discretionary beneficiary in case of "rainy days" needs. The SLAT is a grantor trust. §677(a).

For a detailed discussion of SLATs and "non-reciprocal" SLATs, including a discussion of the §2036 and §2038 issues and creditor issues, see Items 78 and 80 of the ACTEC 2020 Annual

Meeting Musings (Mar. 2020) found **here**, Item 10.i. of Estate Planning Current Developments and Hot Topics (December 2019) found **here**, and Item 16 of the Current Developments and Hot Topics Summary (December 2013) found **here**, all available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For a discussion of potential conflicts of interest between spouses and creditor concerns with SLATs, see Item 10.e of Estate Planning Current Developments (December 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** *See generally* George Karibjanian, *Exploring the "Back-End SLAT" – Mining Valuable Estate Planning Riches or Merely Mining Fool's Gold?*, 47 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. NO. 6 (Nov. 10, 2022).

(7) **GRAT Transfers Not Optimal.** Transfers of real estate investments to GRATs are problematic in various respects. For a classic 2-year GRAT, three appraisals would be needed; one at the initial transfer, a second at the end of year one if part of the asset is distributed in satisfaction of the first-year annuity, and a third at the end of year two. Furthermore, if minority interests are distributed in satisfaction of annuity payments, discounts would apply in determining the value transferred in satisfaction of the pecuniary annuity amount.

i. **Section 754 Elections.** A tax election may be made under §754 for partnerships at a partner's death to adjust the inside basis of the assets in the partnership attributable to the estate's interest to equal the outside basis of the estate's partnership interest (which would be the fair market value of the interest). The advantage is that assets attributable to the estate's interest could be depreciated and sales of those assets would generate less flow-through gain to the estate if the basis adjustment resulted in an upward adjustment of the basis.

Real estate partnerships will often refuse to make the §754 election, though, because they require intricate (and expensive) accounting exercises at each partner's death. Also, marketable and minority discounts could result in the outside basis being less than the estate's pro rata value of the partnership assets, which would result in a step-down of the inside basis of the assets. (That typically would not occur for traditional real estate investments that may have a low inside basis of partnership assets because of depreciation deductions.)

j. **Passive Activity Losses and Material Participation.**

(1) **Passive Activity Losses.** Passive activity losses may not be deducted by individuals, estates, trusts, closely-held C corporations, and personal service corporations. §469(a)(1). A "passive activity" is any activity involving the conduct of a trade or business in which the taxpayer does not materially participate. §469(c)(1).

Any rental activity is considered passive even if the taxpayer materially participates (i.e., it is passive *per se*), §469(c)(2), but an exception for real estate professionals applies (and the rental activity is considered active) if a 2-part test is met: (1) more than one-half the personal services performed by the taxpayer in trades or businesses during the year must be performed in real property trades or businesses in which the taxpayer materially participates; and (2) the taxpayer must perform more than 750 hours of personal services during the year in real property trades or businesses in which the taxpayer materially participates. §469(c)(7).

Material participation requires involvement that is "regular, continuous, and substantial." §469(h)(1).

(2) **Material Participation by Estate of Trust.** The regulations list seven ways for individuals to materially participate)Reg. §1.469-5T(a)) but give no guidance as to how an estate or trust materially participates.

(a) **IRS General Position Based on Legislative History.** The IRS position is that the trustee must be involved directly in the operations of the business on a "regular, continuous, and substantial" basis. The IRS points to the legislative history of §469, which states very simply:

Special rules apply in the case of taxable entities that are subject to the passive loss rule. An estate or trust is treated as materially participating in an activity if an executor or fiduciary, in his capacity as such, is so participating. S. Rep. No. 99-313, at 735.

(b) **Activities by Non-Trustee Employees**. A district court in 2003 concluded that material participation by a trust should be determined by reference to all persons who conducted the business on the trust's behalf, including employees as well as the trustee. *Mattie K. Carter Trust v. U.S.*, 256 F. Supp. 2d 536 (N.D. Tex. 2003).

(c) **Very Strict IRS Position in Private Rulings.** The IRS has taken a strict position in its informal guidance requiring activities by the trustee directly. Tech. Adv. Memo. 201317010 (activities of a "Special Trustee," whose authority as trustee was limited to voting and selling stock, who was president of the business were not counted in determining the trust's material participation because of his limited authority as trustee and because the activities as president were not in the role as fiduciary); Letter Ruling 201029014 (sole means for a trust to materially participate is for the trustee to be involved on a regular, continuous, and substantial basis; taxpayer friendly ruling to the extent it recognized that a trust could materially participate in the activities of a multi-tiered subsidiary through the activities of its trustee even though the trustee had no direct authority to act with respect to the subsidiary's business in its capacity as trustee (because of the remote relationship of the trust to the subsidiary); Tech. Adv. Memo. 201317010 (activities of "Special Trustees" would not be considered in determining the trust's material participation if they did not have the authority to commit the trust to any course of action without approval of the trustees).

(d) ***Frank Aragona Trust v. Commissioner***. In this case of major importance, the Tax Court determined that a trust qualified for the real estate professional exception (which requires material participation by the taxpayer) for rental activities because activities of three of the six co-trustees as employees of the manager of the business are counted in determining material participation by the trust. *Frank Aragona Trust v. Commissioner*, 142 T.C. 2014). All six co-trustees acted as a management board and made all major decisions regarding the trust property. They met every few months to discuss the trust's business. Three of the six were employees of the entity that managed the real estate activities (which constituted full-time participation in the real estate operations).

The *Aragona Trust* case is distinguished from the *Mattie K. Carter Trust* case. In *Aragona Trust*, trustees (half of them) were directly active in the real estate operations, but in *Carter Trust,* only employees of the trust (not trustees) were active in real estate activities. *Aragona Trust* in footnote 15 said that it was not faced with and did not address whether activities by non-trustee employees are considered in determining a trust's material participation.

k. **Valuation; Appraisals.** Valuation discounts often applied to transferred interests. Attaching a qualified appraisal to a gift tax return is often the easiest way of satisfying the adequate disclosure requirements to begin the limitations period on additional assessments. Consider using a "Kovel letter" to document that the attorney engages the appraiser on the client's behalf. Hopefully, the appraisal becomes work product privileged, and if an appraisal is not used on the return, arguably it will not be discoverable.

l. **Co-Ownership.** An entity should typically be used rather than a co-ownership (through a tenancy in common, for example), but co-ownership can be helpful for making sliver gifts of undivided interests in real estate to allow a child to have full-time (but non-exclusive) use of the property without having to pay rent. (A co-owner has a non-exclusive right to occupy property 100% of the time.) See *Stewart v. Commissioner*, 617 F.3d 148 (2d Cir. 2010) (if there is both "continued exclusive possession by the donor and the withholding of possession from the donee," §2036(a)(1) will apply).

A detailed co-ownership agreement should be used to avoid disputes as much as possible. But one planner said it seems sometimes that 20% of his practice is dealing with siblings who have disagreements over the sharing of real estate.

m. **Residences; Vacation Homes.** The parents may want to keep a vacation home in the family in perpetuity (though all children ultimately may not feel the same affinity for the property).

(1) **QPRT.** A qualified personal residence trust (QPRT) is often not ideal for residence transfers. GST exemption cannot be allocated until the end of the ETIP (when the donor's right to use the property ends). If the property is mortgaged, potential gift issues arise each time mortgage payments are made.

(2) **Sale-Leaseback.** The owner may sell the residence and lease the property for the owner's continued use (with fair rental value). Cases have gone both ways regarding whether §2036(a)(1) would apply. Applying §2036 is problematic, because the statute only applies to transfers for less than full and adequate consideration, and the donor would be paying full consideration for the right to use the property. It is ironic that paying rental payments would even further deplete the donor's estate. However, the trend of the cases is not to apply §2036 if adequate rent is paid for the use of the property. *E.g., Estate of Barlow v. Commissioner*, 55 T.C. 666 (1971) (no inclusion under §2036 even though decedent stopped paying rent after two years because of medical problems); *Estate of Giselman v. Commissioner*, T.C. Memo 1988-391; *Estate of Riese v. Commissioner*, T.C. Memo. 2011-60 (following termination of qualified personal residence trust initial term the donor continued to live in the residence for six months until she died unexpectedly without paying rent or executing a written lease, but court found that an agreement existed for the decedent to pay fair market rent; residence not included in estate). The IRS has ruled privately in several different rulings that the donor of a qualified personal residence trust may retain the right in the initial transfer to lease the property for fair rental value at the end of the QPRT term without causing estate inclusion following the end of the QPRT term under §2036. *E.g.,* Letter Ruling 199931028. However, the IRS does not concede that renting property for a fair rental value always avoids application of §2036. *See* Tech. Adv. Memo. 9146002 (*Barlow* distinguished). Most of the cases that have ruled in favor of the IRS have involved situations where the rental that was paid was not adequate. *E.g.*, *Estate of Maxwell v. Commissioner*, 3 F.3d 591 (2d Cir. 1993) (rent payment cancelled out interest payment on note when decedent sold residence to her son and his wife and estate did not pay rent following decedent's death); *Estate of Du Pont v. Commissioner*, 63 T.C. 746 (1975); *Disbrow v. Commissioner*, T.C. Memo 2006-34.

Leaseback transactions should be carefully planned so that the rental amount is the fair rental value for the property. Planners suggest not going over about 10 years on the leaseback arrangement.

(3) **SLATs.** If a residence is transferred to a SLAT with the donor's spouse as a discretionary beneficiary, the trust agreement will likely provide explicitly that the spouse will have the right to occupy the residence rent-free. What if the donor continues living in the residence (as the spouse of the beneficiary)? The IRS concedes that continued co-occupancy for interspousal transfers will not of itself support an inference or understanding as to retained possession or enjoyment by the donor. *E.g., Estate of Gutchess v. Commissioner*, 46 T.C. 554 (1966), *acq.*, 1967-1 C.B. 2; Rev. Rul. 78-409, 1978-2 C.B. 234; Rev. Rul. 70-155, 1970-1 C.B. 89; Letter Ruling 200240020. However, the IRS is not as lenient when the residence is given to family members other than the spouse if the donor continues living in the residence. *See, e.g.*, *Estate of Maxwell v. Commissioner*, 3 F.3d 591 (2d Cir. 1993); *Estate of Trotter v. Commissioner*, T.C. Memo. 2001-250; *Estate of Adler v. Commissioner*, T.C. Memo. 2011-28; Tech. Adv. Memo. 200532049.

Keep in mind, the key word with SLATs is "Spousal." If the donor is no longer married to the beneficiary, issues get very complicated.

n. **Promoter.**

(1) **Typical Arrangement.** An example arrangement could be a client that contributes land worth $5 million and $5 million of cash to an LLC for a 10% Class A interest. An equity investor would contribute $90 million cash for a 90% Class A interest. The client would also receive a Class B

"Promote" interest with no invested capital. (Why would the client receive this Class B interest for no additional investment? For the entrepreneurial risks that passive limited partners are not undertaking and because the client may bear higher risk if she personally guarantees transaction financing.) A separate management company owned by only the client will be the manager of the LLC.

Net cash flow and profits are allocated as follows:

- Class A members up to the first $110 million received (a 10% IRR).
- Next, net cash flow and profits are allocated 25% to the Class B interest and 75% to the Class A interest until the Class A interest has received $120 million (a 20% IRR).
- Afterward, net cash flow and profits are allocated 40% to the Class B interest and 60% to the Class A interest.

Thus, after hurdles are met, the client's Promote interest receives 40% of the cash flow even though the client only invested 10% of the equity.

(2) **Transfer of the Class B "Promote" Interest.** No capital is associated with the Class B interest, and the client might take the position that it has no value initially. Of course, that is not correct, but the initial value of the Class B interest may be relatively low compared to the Class A interests that are backed by $100 million of capital, and the Class B interest receives nothing until the Class A interest has recouped its $100 million investment plus $10 million (representing 10% IRR).

(a) **Section 1061.** The 2017 TCJA generally preserves the capital gain treatment of "carried interests" (the "Promote" interest in the example above; investment funds reference "carried interests" and real estate transactions typically reference "Promote" interests). It renumbered §1061 to §1062 and added a new §1061 that applies to a "carried interest" (which it refers to as an "applicable partnership interest"). The owner of the carried interest must provide substantial services and hold the interest at least three years to qualify for capital gains rates.

(b) **Overview of Risks of Estate Planning Transfers of Promote Interests.** Risks and pitfalls of transferring Promote interests include §2701 (discussed below), §2036 retained interest issues, valuation uncertainties for gift tax purposes, incomplete gift issues for unvested interests, trust and entity attribution rules, and qualified purchaser and accredited investor rules. See N. Todd Angkatavanich, David A. Handler, and Ivan Tabak, *Wealth Transfer Planning with Interests in Private Investment Funds and Other Closely-Held Entities,* 50th Heckerling Inst. On Est. Pl., at Section III.D (2016).

(c) **Section 2701; Carry Derivative Contract.** Section 2701 applies Draconian rules that value "Promote" interests at very high values when they are transferred while retaining the capital interests. One way of avoiding those rules is to make vertical slice gifts; proportionately gift the same portion of the owner's Class B and Class A interests. But often the client wants to transfer just the Class B interests that have a very low initial value compared to amounts that they may receive if (and only if) the real estate transaction is successful.

An alternative approach is the carry derivative contract. The client would sell to the trust the economic rights associated with the Class B interest but not the Class B interest itself, a planning alternative developed by David Handler (Chicago, Illinois). *See* David Handler, *Naked Derivatives and Other Exotic Wealth Transfers*, 50th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 8 (2016). For a summary of David Handler's comments regarding general planning with private derivatives, see Item 15 of the Current Developments and Hot Topics Summary (December 2016) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

A planner reports that he has employed the carry derivative contract alternative various times, working with David Handler's firm.

31. Tax Risks if Exempt and Non-Exempt Trusts Created Under a Trust Agreement Have Differing Terms, Private Letter Rulings 202507005 (Feb. 14, 2025) and 202531005 (Aug. 1, 2025)

a. **Brief Summary.** Private Letter Rulings (PLR) 202507005 (Feb. 14, 2025)) and 202531005 (Aug. 1, 2025) raise serious tax risks associated with trusts whose terms vary depending on whether Generation-Skipping Transfer (GST) exemption is allocated.

In PLR 202507005, withdrawal rights and appointment powers differ based on whether the trust portion is GST-exempt or non-exempt. The beneficiary had incremental withdrawal rights over only the non-exempt trust, had a testamentary general power of appointment over the non-exempt trust, and had a testamentary limited power of appointment over the exempt trust.

Both rulings granted an extension to allocate GST exemption but notably "express[ed] no opinion" as to whether the settlor's retained power to make a late allocation could cause inclusion in the estate under §§ 2036(a)(2) or 2038 or trigger an estate tax inclusion period (ETIP). Accordingly, the ruling expressed no opinion "as to the effect of an allocation of GST exemption made pursuant to this grant of relief."

Interestingly, PLR 202507005 made reference only to the difference in the withdrawal rights over the exempt and non-exempt trust (not the difference in the testamentary powers of appointment over the exempt and non-exempt trusts). Did that mean the IRS was not concerned with differences in the testamentary powers of appointment? Unfortunately, that is not the case. In PLR 202531005, the only difference was the testamentary powers of appointment, and the ruling referenced "Donor's power to alter a beneficiary's testamentary power of appointment" by the ability to change the portion of the trust that exempt from GST tax through a late allocation of GST exemption.

The IRS agents may in the future make arguments that the retained power to make a late allocation of GST exemption, if the trust has differing terms for exempt and non-exempt trusts, creates:

- A potential for estate inclusion under §§ 2036(a)(2) and 2038,
- An ETIP preventing effective GST allocation until expiration of that period,
- And, possibly, an incomplete gift for gift tax purposes.

These concerns stem from the settlor's ability to shift beneficial interests by choosing whether or not to allocate GST exemption and even to "undo" an election not to allocate GST exemption under a ruling request from the IRS.

These potential problems could be avoided by drafting the exempt and non-exempt portions of trusts to be identical (with the possible flexibility of giving someone the authority to grant general powers of appointment to beneficiaries). Affirmatively allocating GST exemption to the trust so that it is fully exempt may ameliorate the risk. Planning techniques like decanting or trust modification are possible alternatives to may mitigate these risks (but a trust modification requiring the settlor's consent may require a 3-year waiting period under §2035 to avoid the §2036(a)(2) and §2038 and ETIP risks).

b. **Summary of PLR 202507005 and PLR 202531005.**

(1) **Overview of Trust Terms in PLR 202507005**. The donor created a trust benefiting the donor's spouse and descendants. Upon the spouse's death, the trust divides into shares for each child. Notably, withdrawal rights and appointment powers differ based on whether the trust portion is GST-exempt or non-exempt:

- Non-Exempt Portion: The child has incremental withdrawal rights and may appoint the remainder to descendants and creditors.
- Exempt Portion: The child has no withdrawal rights and may appoint the remainder only to descendants.

This bifurcation creates differing economic interests contingent upon GST allocation, which is central to the concerns raised by the IRS.

(2) **Overview of Trust Terms in PLR 202531005.** In PLR 202531005, the only differences between the exempt and non-exempt trusts were the beneficiary's testamentary powers of appointment over the trusts. The beneficiary had a limited power of appointment over the exempt trust (to appoint assets to the beneficiary's issue). The beneficiary had a testamentary formula power of appointment over the non-exempt trust. It was a general power of appointment, but if that "would subject the GST Non-Exempt Trust to tax at a rate greater than or equal to the rate of GST tax, then the beneficiary has a testamentary power of appointment in favor of the beneficiary's issue." Perhaps the intent was to have a general power of appointment over a portion of the non-exempt trust, but only a limited power of appointment over the portion of the trust that would otherwise be subject to an estate tax rate greater than or equal to the GST tax rate. (That type of testamentary formula general power of appointment is often seen in trust agreements for non-exempt trusts.

(3) **Outcome in the Rulings.** The IRS granted the donor an extension under § 2642(g) to allocate GST exemption in both rulings. However, the IRS expressed no opinion whether "Donor's power to alter the child's withdrawal rights" (in PLR 202507005) or "Donor's power to alter a beneficiary's testamentary power of appointment" (through a late allocation of GST exemption)–

- Would cause the trust to be includible in Donor's estate under s §§ 2036(a)(2) and 2038 inclusion, or
- Cause any portion of the trust to be subject to an estate tax inclusion period (ETIP) under §2642(f), and therefore, the IRS expressed "no opinion as to the effect of an allocation of GST exemption made pursuant to this grant of relief."

Interestingly, PLR 202507005 made reference only to the difference in the withdrawal rights over the exempt and non-exempt trust (not the difference in the testamentary powers of appointment over the exempt and non-exempt trusts). Did that mean the IRS was not concerned with differences in the testamentary powers of appointment? Unfortunately, that is not the case. In PLR 202531005, the only difference was the testamentary powers of appointment, and the ruling referenced "Donor's power to alter a beneficiary's testamentary power of appointment" by the ability to change the portion of the trust that exempt from GST tax through a late allocation of GST exemption

This refusal creates considerable uncertainty for practitioners and taxpayers alike.

c. **IRS Arguments About § 2036(a)(2), § 2038, ETIP, and Incomplete Gift.**

(1) **§ 2036(a)(2) / § 2038 Inclusion.** The IRS may take the position that the donor has retained the ability to shift beneficial enjoyment (e.g., giving the child access to trust assets or not through the withdrawal power over the non-exempt trust) depending on whether GST exemption was allocated. This retained power may exist indefinitely because of the donor's power to make a late GST allocation (even if the donor had previously opted out of making a GST exemption allocation if the donor obtains an IRS ruling allowing such late allocation). If allocation of GST exemption would change withdrawal rights or appointment powers, this is arguably a retained power to alter beneficial interests " under §2036(a)(2) and a power to "alter, amend, or revoke" the trust under §2038.

(2) **ETIP.** An estate tax inclusion period (ETIP) is a period during which the transferor retains an interest or power that would cause the value of trust property to be included in the transferor's gross estate for estate tax purposes if he died. §2642(f)(3). The significance is that no GST exemption allocation may be made during the ETIP until it has ended. §2642(f)(1).

The IRS may take the position that the power to make a late GST allocation effectively delays finalization of beneficial interests, thus suspending the ability to allocate GST exemption to the

trust until the ETIP ends—possibly three years after the donor relinquishes that power (because of §2035).

(3) **Incomplete Gift Issue.** The IRS did not mention this issue in PLR 202507005, but The IRS may take the position that a gift to the trust is incomplete because the donor retains control over GST allocation, which in turn affects beneficial rights. A transfer is a completed gift only to the extent that the donor "has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another." Reg. § 25.2511-2(b). A transfer is generally incomplete to the extent that the donor retains the power to change the interests of the beneficiaries among themselves. Reg. § 25.2511-2(c).

A consequence is that the gift may not become complete until the statute of limitations runs on the gift tax return reporting the transfer as a completed gift. A compounding effect is that if the gift is incomplete, the donor cannot effectively allocate GST exemption during that time—raising concerns about the validity of the GST allocation— and upon the donor's death the assets will probably be included in the donor's gross estate.

(4) **Varying Situations In Which the IRS Could Make These Arguments.** These arguments could apply in varying situations, such as (1) the donor has not allocated sufficient GST exemption to result in a zero inclusion ratio and retains the ability to make a late allocation or to seek ruling to make a timely election (even though made late), or (2) the donor opted out of an automatic allocation on the gift tax return (under §2632(b)(3) for allocations to lifetime direct skips or under §2632(c(5)(B)(i) for allocations to GST trusts) but retains the ability to seek a ruling allowing allocation of GST exemption. The procedures for obtaining rulings in these situations are detailed in Reg. 26.2642-7. If the donor has made an affirmative allocation of GST exemption, that is generally irrevocable, but regulations allow "undoing" the affirmative allocation in a few (very limited) specific circumstances. Reg. 26.2642-7(e)(2).

d. **Huge Problem.** These private letter rulings create a **huge problem** because tens or hundreds of thousands of trusts provide for differences in testamentary powers of appointment for exempt and non-exempt portions of the trust. Over 40 years have passed since the enactment of the GST tax, and the IRS has never previously suggested this Draconian result, implicitly acknowledging that these differences were permissible without causing catastrophic results. If the differences between exempt and non-exempt trusts cause an ETIP to apply, any allocation of GST exemption would not be effective. Many thousands of trusts that clients think are GST exempt may not be under the IRS's position.

There are informal indications that IRS may intend to pursue these positions in future estate audits, especially where the inclusion ratio is not zero and the donor's allocation decision alters beneficial rights. The possibility of inclusion under §2036 and §2038, the existence of an ETIP, and gift incompleteness all pose substantial risk for taxpayers with similar trust structures. But, perhaps the IRS will change its position. A planner has indicated that he anticipates receiving, before the end of the year, a ruling granting an extension to make a late allocation or ruling that automatic allocation applied to a transfer. It will be interesting to see if this additional "we express no opinion" paragraph is included in that ruling.

e. **Planning Considerations, Including Possible Alternatives to Mitigate These Risks.**

(1) **Avoid Trust Terms that Shift Based on GST Exemption Status.** These potential problems could be avoided by drafting the exempt and non-exempt portions of trusts to be identical (with the possible flexibility of giving someone the authority to grant general powers of appointment to beneficiaries). If the planner opts to use this approach, do not differentiate trust terms (e.g., withdrawal rights or GPA powers) depending on whether a trust is exempt or not. Use uniform provisions that apply regardless of GST status to prevent § 2036 or § 2038 exposure, which would also avoid having an ETIP. For example, an alternative would be to include formula general powers of appointment in both exempt and non-exempt trusts (but the formula would never be triggered

in any exempt trusts because transfer taxes would not be reduced by the grant of a general power of appointment).

(2) **Avoid Retained Powers That Depend on Later Allocation Decisions.** Practitioners concerned with this risk should avoid drafting trusts that leave the donor with effective post-transfer control over beneficiary rights through discretionary GST exemption allocation. Where GST allocation is intended, donors might consider using a binding agreement to allocate exemption as consideration for trustee acceptance, akin to arrangements commonly used in charitable trusts.

(3) **Affirmatively Allocate GST Exemption; But May be Unable to Allocate GST Exemption (Until End of ETIP).** Affirmatively allocating GST exemption to a trust sufficient for the trust to have a zero inclusion ratio (so no non-exempt trust is created), should ameliorate the concern, because the IRS will not grant relief "to decrease or revoke an affirmative allocation (as opposed to an automatic allocation) of GST exemption." Preamble to Final Regulations, §26.26742-7, TD 9996 (RIN 1545-BH63) (published in Federal Register May 6, 2024). Therefore, the grantor would have no ability to shift the trust terms from the exempt to the non-exempt trust terms. If GST exemption is allocated to the trust later, the IRS might argue that an additional three-year period of inclusion should apply under §2035(a).

Even though affirmative allocation of GST exemption to make the trust fully exempt may seem to reduce the concern, the IRS might conceivably raise a "chicken and egg" problem. If the trust has different terms in the exempt and non-exempt trusts, so that the ability to shift benefits based on how GST exemption is allocated causes estate inclusion, the IRS suggests that may create an ETIP. Any allocation of GST exemption during the ETIP is ineffective. The allocation of GST exemption may resolve the inclusion issue, but the allocation may be ineffective (because of the ETIP).

This problem would apply even as to a timely allocation of GST exemption soon after the trust is created. From the time the trust is funded until GST exemption is allocated, the grantor has the ability to shift beneficial interests by the decision of whether or not to allocate GST exemption. Theoretically, this means that trusts with differences between the exempt and non-exempt trusts may not have had GST exemption effectively allocated to the trust even though clients may think GST exemption was allocated to the trust to make it an exempt trust decades ago.

(4) **Trusts Exempt by Automatic Allocation May Still Be Subject to the Risk**. If the trust is fully exempt by reason of allocation of GST exemption under the automatic allocation rules, that same reasoning may not apply because the preamble to Reg. §2642-7 (as quoted above) suggests that the grantor may have the ability to seek later relief to decrease or revoke an automatic allocation of GST exemption (although anecdotal experience is that such relief would be difficult to obtain absent explicit contemporary documentation that the automatic allocation was not intended). (In addition, the preamble states that "[t]he Treasury Department and the IRS will address the effect of a grant of relief on automatic allocations in future guidance to be issued under section 2642(g).") *See e.g.*, Letter Rulings 202547002 & 202547006. However, the IRS's position is that an "election in" to automatic allocation (i.e., electing to treating the trust as a "GST trust") cannot be changed.

(5) **Trusts With Formula General Powers of Appointment in Non-Exempt Trusts May Nevertheless Qualify for Automatic Allocation.** The IRS has issued three PLRs taking the position that a trust with a testamentary formula general power of appointment (with a power to appoint over 25% of the principal of the trust, which might suggest it is not a GST trust under §2632(c)(3)(B)(iii)) is nevertheless a GST trust because of the contingency of whether the formula general power of appointment applies. PLRs 202210010, 201925013, & 201924016. Accordingly, if GST exemption has not been affirmatively allocated to a trust with a testamentary formula general power of appointment, the donor might be able to seek a letter ruling to confirm that automatic allocation applied from when the trust was created. Even without seeking a ruling, a

donor might be able to argue, under the reasoning of PLR 202210010 (as terse as that reasoning is), that the trust has always been fully exempt because GST exemption was automatically allocated, and, therefore, there would be no §2036-§2038 inclusion or ETIP.

(6) **Facts of Independent Significance.** A strong argument to counter a possible IRS position for estate inclusion is that the decision to allocate or not allocate GST exemption is a fact of independent significance. The decision is made to cause the trust to be exempt or non-exempt from the GST tax, not to shift benefits. Marrying a spouse, having a child, or making income tax elections may have collateral implications under trust agreements, but those things are not done to shift benefits.

(7) **Ability to Seek IRS Ruling for Late Allocation Relief Should Not Trigger Inclusion.** The extent to which additional GST exemption could be allocated under an IRS ruling to allow a late allocation as if made timely should not trigger estate inclusion, because it is something the government has to grant and is not within the control of the transferor.

(8) **Finality of Inclusion Ratio.** One way to cause the statute of limitations to run on the inclusion ratio of the trust is to make a small taxable distribution after transferor's death. The distribution should be reported on a Form 706(GS)D taking the position that the trust has a zero inclusion ratio. Following the later of (i) three years after the Form 706(GS)D is filed or (ii) the expiration of the period of assessment for estate taxes with respect to the on the transferor's estate, the inclusion ratio will be determined with finality. *See* Reg. §26.2642-5(b). However, that does not help for the long period of time of the trust's existence when the transferor is still alive.

(9) **Existing Trusts.** Planners may consider reviewing existing trust instruments for potential exposure and taking proactive steps to mitigate risk before an audit or death of a transferor brings these issues to the fore.

In cases where the trust already exists, and allocation is contemplated or has not yet occurred, careful analysis should be made as to whether the gift was complete, whether the trust falls within an ETIP, and whether any allocation would be effective. Disclosure on a timely filed Form 709 remains essential to protect against an incomplete gift challenge (after the statute of limitations has run on the gift tax return). Where possible, allocations should be structured to result in an inclusion ratio of zero, though practitioners should recognize that even this may not resolve all issues under the IRS's current reasoning.

(10) **Decant or Reform Problematic Trusts.** If a trust is already in place with variable terms based on exemption status, decanting may be possible to eliminate distinctions between exempt and non-exempt portions. If the trust is reformed to mitigate the §2036/§2038 issue and ETIP issue in an action that requires the consent of the donor, estate inclusion and a continuing ETIP will exist for an additional three years because of §2035(a) (the donor will be deemed to have "relinquished a power," as described in §2035(a)(1)).

(11) **Use of Formula Clauses or Safe Harbors.** Consider including clauses that fix the allocation as of the date of gift or that require proportionate allocations if the trust ends up with a mixed inclusion ratio.

(12) **Not a New Concern.** For decades, commentators have noted these possible arguments if the terms of exempt and non-exempt trust are not the same and if the instrument requires the trustee to divide the trust based on inclusion ratios.

> If the provisions governing the exempt and nonexempt trusts are different, and if the grantor has the power to reduce the nonexempt trust by allocating additional GST tax exemption to the trust, then the grantor's power could be considered to be a power to alter the beneficial enjoyment of the assets held in the trust. For example, suppose that the beneficiary of a nonexempt trust has the right to withdraw trust assets at any time after attaining the age of 35 but the assets in the exempt trust remain in trust for life. If the grantor's allocation of additional GST tax exemption to the trust may have the effect of reducing the amount subject to withdrawal, the grantor's allocation of GST tax exemption alters the beneficial enjoyment of trust assets held in the nonexempt trust. Under the terms of the trust, the grantor's allocation of GST tax exemption by itself

may be insufficient to reduce the nonexempt trust and thereby change a beneficiary's rights.1 However, if the trustee were *required* under the terms of the instrument to divide the trust based on inclusion ratios, including inclusion ratios that change as a result of a late allocation of GST tax exemption, the argument that the grantor's control over allocations of GST tax exemption has tax consequences appears to be stronger. This issue could be avoided by having uniform dispositive provisions for the exempt and nonexempt trusts in the case of lifetime trusts so that the allocations between exempt and nonexempt trusts do not create any differences in the beneficiary's rights of beneficial enjoyment. Also, the ability to alter the trust by allocating additional GST tax exemption to the trust ceases to be applicable if the grantor no longer has any exemption left to allocate.

Ellen Harrison, *Generation-Skipping Planning in Light of EGTRRA*, 39TH ANN. HECKERLING INST. ON EST. PL. ¶1002.6 (2005).

If the trustee is not *required* to divide a trust into exempt and non-exempt trusts when a trust acquires a new inclusion ratio, Ellen observed in footnote 84 that "the grantor's allocation of GST tax exemption is necessary but insufficient to alter beneficial enjoyment. An argument could be made that the power is one described in IRC § 2036(a)(2), which includes in a decedent's estate property subject to a power exercisable by the decedent in conjunction with another person." *Id.*

(13) **Policy Concerns With IRS Position – "Forty Years of Gotcha Is Just Wrong."** The IRS has had over 40 years (since 1981) to let taxpayers know that the ability to allocate GST exemption in these circumstances could have devastating tax results. Doing so now as to pre-existing trusts seems extremely unfair. Carol Harrington (Chicago, Illinois) has explained her "policy thoughts" regarding these positions that the IRS may be taking in future audits.

1. The ability to allocate GST exemption or not should be treated as a fact of independent significance. Just as you don't marry or have a child to shift interests in an irrevocable trust, you don't allocate GST exemption or forgo that allocation to shift interests.

2. The ability to make a tax election is granted by the government and if there are property law detriments to making or not making the election, the government should tell us that clearly when the election is granted. In my view, an election is supposed to be useful to the TP and should not be treated as a property right that implicates 2036 or causes an incomplete gift. TPs do not make the trust terms different because they are trying to retain control, but only because they are trying to minimize taxes, which is their right. The GSTT was supposed to backstop the estate and gift tax system rather than imposing a punitive tax on trusts and these shifting provisions are used because in fact the GSTT can result in more tax than if the property has passed outright. This could be solved with an election like the QTIP election to include certain trusts in the estate of a beneficiary when his/her death would otherwise be a TT.

3. The government has had 40 years to let us know or even give us a hint that it thinks the ability to allocate or not allocate in these circumstances could make the gift incomplete or includable under 2036. If this is where they choose to go, they should issue and adopt regulations and apply those regs only to trusts irrevocable after they are adopted. Forty years of gotcha is just wrong.

4. Now that they have raised this issue, they need to issue a ruling or other direction that a timely allocation relates back to the date of a gift made during life for all purposes, so that there is no incomplete gift if that occurs and no inclusion under 2036. In addition, they should issue guidance that the treatment of lifetime trusts is parallel to the one for trusts included in the gross estate, so that a direction to the trustee of a lifetime trust to divide a trust that is greater than the GST exemption timely allocated into trusts with 0 and 1 IRs should be treated as effective as of the date of the gift so that the trusts are separate from that date.

32. Loan of Money for Note Bearing AFR Interest Rate Is Valued at the Face Amount of the Note for Gift Tax Purposes under Section 7872 (As Long as the Loan is a Bona Fide Loan), *Estate of Galli v. Commissioner* (Tax Court Docket Nos. 7003-20 & 7005-20, March 5, 2025)

a. **Brief Summary.** Barbara Galli loaned $2.3 million to her son in return for an unsecured 9-year balloon note, with interest at the applicable federal rate (AFR), providing for annual payments of interest with the principal being due at the end of nine years. The loan transaction was not reported on a gift tax return. The son made three annual interest payments, and Barbara reported the interest as income

on her income tax return. Soon after the third interest payment was made, Barbara died, and her estate reported the note as having a value of $1.624 million, representing an almost 30% discount.

The IRS took the position that the initial loan resulted in a gift of $869,000 because it was not reasonably comparable to commercial loans and because of concerns about the son's ability or intent to repay the loan. The IRS also determined that the note was undervalued on the estate tax return by $544,000.

The estate moved for summary judgment in the gift tax case and for partial summary judgment in the estate tax case.

Two separate issues arise regarding the gift tax treatment of the loan. First, is it disregarded entirely as not being a bona fide loan with a reasonable expectation of repayment so the entire transfer is a gift? Second, if that is not the case, how is the note valued? The court's Order determines that the IRS did not plead that the loan was not bona fide, such that the entire transaction should be characterized as a gift (and even if it had, such position was not supported with adequate proof).

As to the valuation of the note, the Order concludes that §7872 governs the field of loans with below-market interest rates. The Order cites *Frazee v. Commissioner*, 98 T.C. 554 (1992), regarding whether to characterize a loan as a partial gift if it carries an interest rate below market but equal to or above the AFR. It quotes the *Frazee* opinion: "[In §7872] Congress displaced the traditional fair market methodology of valuation of below-market loans by substituting a discounting methodology." Despite the IRS allegations that the note was unsecured and was not comparable to commercial loans, the Order concludes very succinctly that "under [section 7872], this transaction was not a gift at all." The Order also granted the estate's motion for partial summary judgment for the estate tax case (presumably to say the note did not have to be valued at its face amount without a discount). *Estate of Galli v. Commissioner*, T.C Docket Nos. 7003-20 & 7005-20 (March 5, 2025, Judge Mark V. Holmes).

b. **Court Analysis.**

(1) **IRS Position in Notices of Deficiency.** The IRS alleged underpayment of gift tax and estate tax. The court quoted at length from the notices of deficiency (which were identical in relevant part). The court emphasized that it would undergo a "close reading" of the passages italicized by the court.

> Key Facts: The decedent lent $2.3 million to her only child on February 25, 2013, at which time she was 79 years of age. *The terms of the loan were set forth in a note that provided for a 9 year term* and interest at an alleged applicable federal rate of 1.01 %. The note provided for annual payments of interest, with repayment of the principal due at the end of the term: The loan was unsecured and *the note lacked provisions necessary to create a legally enforceable right to repayment reasonably comparable to the loans made between unrelated persons in the commercial marketplace. It has not been shown that the borrower had the ability or intent to repay the loan. It has not been shown that the decedent had the intent to create a legally enforceable loan, or that she expected repayment*. The decedent did not file a gift tax return relating to the loan. *The borrower made annual payments of interest* as required during February of 2014, 2015 and 2016. On March 7, 2016, the decedent died, leaving a taxable estate that included the loan repayment obligation reflected by the note. Under the estate plan, the borrower inherited the note. For estate tax purposes, the estate valued the note at $1,624,000. The difference between the amount lent and the fair market value of the note then determined by the IRS is $869,000.
>
> Primary Determination: *The amount by which the value of money lent in 2013 exceeds the fair market value of the right to repayment set forth in the note is a previously unreported and untaxed gift*. The fair market value of future payments to be made under the note when the loan was made is determined by the IRS appraisal. See I.R.C. section 2512 and the regulations thereunder. In the absence of significant risk that the amount lent will not be repaid, discounting the present value of future payments only to reflect the time value of money can be appropriate. See Frazee v. Comm'r, 98 T.C. 554 (1992). In contrast, where significant repayment risk is present, the present fair market value of future payments must take into account the risk of nonpayment, in addition to any discount required to reflect the time value of money. See, e.g., Dallas v. Commissioner, T.C. Memo. 2006-212, *10 (discounting the value of self-canceling installment notes in the bargain sale context to reflect risk of non-payment). Here, the estate reported the value of the note at a value that discounts the future payments due under the note in an amount which reflects risk of non-payment,

over and above time value of money considerations. The principles of asset valuation are to be applied consistently for gift tax and estate tax purposes, consistent with the doctrine of in pari materia. In addition, the duty of consistency precludes the estate from maintaining inconsistent valuation approaches for gift and estate tax in order to avoid gift tax on a transaction designed to reduce estate tax. Accordingly, *there is a previously unreported and untaxed gift, in the amount of $869,000, subject to estate tax*.

Alternative Determination: For purposes of determining the value of the gross estate, the value of the note must be determined by discounting the value of future payments to reflect time value of money considerations only, by applying the applicable federal rate. This approach mirrors the reporting position of the decedent when the decedent did not report gift tax with respect to the loan in 2013. Under the alternative determination, the value of the gross estate for estate tax purposes is increased by $544,000.

(2) **Estate's Position.** The estate contested both the Primary Determination and Alternative Determination by the IRS in the notices of deficiency.

As to the gift tax issue, the IRS's Primary Determination (that the risk of non-payment should be considered in valuing the note received in the loan transaction) does not argue that the note should be disregarded and valued at zero. The court summarized the estate's position this way: "This means IRS § 7872(c) of the Code applies, and under that section this transfer is a pure loan because that section's minimum interest rate for loans was charged." In effect, §7872 means that a note given in return for a loan is valued at face and collectability/non-payment issues are irrelevant in valuing the note.

As to the estate tax issue, the IRS's Alternative Determination is that the note should be valued considering time value of money issues only and collectability/non-payment risks should not be considered. However, valuing the note at less than face value for estate tax purposes "is simply a reflection of different rules … for the estate tax – not any violation of any duty of consistency."

(3) **IRS Did Not Take the Position That the Loan Was Not Bona Fide And Should Be Recharacterized Entirely as a Gift.** The "Key Facts" summary in the notices of deficiency have some statements questioning the bona fides of the loan:

- The note lacked provisions necessary to create a legally enforceable right to repayment;
- The terms were not reasonably comparable to the loans made between unrelated persons in the commercial marketplace;
- It has not been shown the borrower had the ability or intent to repay the loan;
- It has not been shown the decedent had the intent to create a legally enforceable loan; and
- It has not been shown the decedent expected repayment.

The actual "Primary Determination" by the IRS, however, was that the amount by which the amount loaned exceeded the value of the right to repayment is an unreported and untaxed gift. If a significant repayment risk exists, the fair market value of future payments must take into account the risk of non-payment, and, indeed, the value of the note reported in the estate tax return takes into account the risk of non-payment.

The court acknowledged that cases have established a multiprong test for determining whether a transfer of money is treated as a loan, citing the lead cases, *Estate of Maxwell v. Commissioner*, 98 T.C. 594, 604-05 (1992); *Miller v. Commissioner*, 71 T.C.M. 1674, 1679 (1996).

The court analyzed the positions of the IRS as stated in the notices of deficiency and concluded "the Commissioner hasn't made recharacterization of the entire transaction as a gift an issue in this case and, even if he had, did not support his position with adequate proof."

(4) **Valuation of Note for Gift Tax Purposes; Effect of §7872.** The court viewed this issue as the "much easier part" of the estate's motion for summary judgment. The estate's position was "that section 7872 governs the field of loans with below-market interest rates." In effect, the argument is that if the loan bears an interest rate at least equal to the AFR, it will be valued at its face amount for gift tax purposes. Even though the interest rate is below the market rate, the

court viewed *Frazee v. Commissioner*, 98 T.C. 554, 558 (1992) as having answered this issue. The court quoted Frazee to note that in §7872 "Congress displaced the traditional fair market methodology of valuation of below-market loans by substituting a discounting methodology." The court concluded that under §7872, "this transaction was not a gift at all."

The court entered a Stipulated Decision on April 3, 2025, in Docket No. 7005-20 granting petitioner's motion for summary judgment and deciding that "there is no deficiency in gift tax due from, nor overpayment due to, petitioner for taxable year 2013."

(5) **Estate Tax Valuation of Note.** The court does not directly address the estate tax valuation issue but grants petitioner's motion for partial summary judgment (which presumably is to deny the IRS position that the note must be valued for estate tax purposes without regard to risk of non-payment issues). Presumably, the court will later determine the value of the note for estate tax purposes.

c. **Observations.**

(1) **Other Pending Examinations and Tax Court Cases.** The IRS is taking similar positions, that notes bearing interest at the AFR should be valued at less than face because of possible collectability factors, in other cases, including cases involving sales to grantor trust transactions. For example, one such case is *Estate of Sakioka v. Commissioner*, T.C. Docket Nos. 7132-19 & 7138-19 (set for trial Jan. 12, 2026).

(2) **Very Important Principle: Note Received in a Loan Transaction Will be Valued at Face If Interest Rate Equals or is Greater Than AFR, Regardless of Any Risk of Non-Payment.** This has been a "hot" issue with the IRS in gift tax examinations. The IRS in various examinations has taken the position that the notes given in return for cash loans or in sale transactions should be valued taking into consideration non-payment risks; simply using an AFR note does not make non-payment risks irrelevant in valuing the note.

Two issues, among others, can arise in valuing notes given in a loan or sale transaction. First, with respect to the present value of the note payments, what baseline should be used for determining the present value? The IRS takes the position sometimes that using the AFR is not sufficient and sometimes that §7872 applies to cash loans but not sales. Various cases seem to make clear the §7827 applies for these purposes. Second, should other non-payment risks that may impact the value of the note be considered? The *Galli* Order answers no to that question. The IRS has been raising these two issues repeatedly in gift tax examinations.

The Order in *Galli* follows two other Tax Court cases (*Frazee v Commissioner*, 98 T.C. 554 (1992) and *Estate of True v. Commissioner*, T.C. Memo. 2001-167) supporting this position. The *Galli* Order quotes from *Frazee*, in effect suggesting that the adoption of §7872 changed the approach to the valuation of notes received in loan transactions, and that as long as the note bore interest at or above the AFR, the note would be valued at face for gift tax purposes by saying "Congress displaced the traditional fair market methodology of valuation of below-market loans by substituting a discounting methodology."

The notices of deficiencies quoted in the *Galli* Order cited only one case to support the IRS proposition that if a significant repayment risk exists, the present value of future payments must take into account non-payment risks. The notices of deficiencies cite it this way: "See, e.g., Dallas v. Commissioner, T.C. Memo. 2006-212, *10 (discounting the value of self-cancelling installment notes in the bargain sale context to reflect risk of non-payment)." However, discounting the actuarial risk that payments would not be payable because of a premature death is not accounting for non-payment risks; it reflects explicit contingencies in what payments would be due under the notes pursuant to the note terms, not just general collectability or non-payment risks of note payments that are due under the note.

But arguments can be made to the contrary, discussed in subparagraph (4) below.

(3) **Bona Fide Loan Transaction Issue.** A transfer may be treated entirely as a gift, despite the fact that a note was given in return for the transfer, if the loan is not bona fide and if there appears to be an intention that the loan would never be repaid. Various cases have consistently applied this concept. Some cases list nine factors that are determinative. *E.g. Miller v. Commissioner*, T.C. Memo. 1996-3, *aff'd*, 113 F.3d 1241 (9th Cir. 1997); *Estate of Bolles v. Commissioner*, T.C. Memo. 2020-71. Others list eleven factors. *E.g.*, *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40; *Estate of Rosen v. Commissioner*, T.C. Memo. 2006-115 (detailed analysis of eleven bona fide loan factors as applied to transfers from an FLP).

The *Bolles* case briefly summarizes its nine factor test:

> Those factors are explained as follows: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.
>
> These factors are not exclusive. See, e.g., Estate of Maxwell v. Commissioner, 98 T.C. 594 (1992), aff'd, 3 F.3d 591 (2d Cir. 1993). In the case of a family loan, it is a longstanding principle that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the tax characterization of the transaction as a loan. Estate of Van Anda v. Commissioner, 12 T.C. 1158, 1162 (1949), aff'd per curiam, 192 F.2d 391 (2d Cir. 1951).

The eleven factor test interestingly has a number of different factors. Those factors were listed in *Estate of Moore* as follows:

- the name given to the instrument underlying the transfer of funds;
- the presence or absence of a fixed maturity date and a schedule of payments;
- the presence or absence of a fixed interest rate and actual interest payments;
- the source of repayment;
- the adequacy or inadequacy of capitalization;
- the identity of interest between creditors and equity holders;
- the security for repayments;
- the transferee's ability to obtain financing from outside lending institutions;
- the extent to which repayment was subordinated to the claims of outside creditors;
- the extent to which transferred funds were used to acquire capital assets; and
- the presence or absence of a sinking fund to provide repayment.

For an outstanding discussion of practical formalities that should be followed to satisfy these tests, see Alan Gassman, Peter Farrell & Nickolas Tibbetts, *Galli: Good Galli Miss Molly Tax Court Finds That a Taxpayer's Family Loan Was Not a Gift, but That Doesn't Mean That the Applicable Federal Rate is Acceptable Between an Irrevocable Trust and Its Grantor*, LEIMBERG ESTATE PLANNING NEWSLETTER #3201 (May 5, 2025). The article points out that distinctions between the facts of *Galli* (treatment as a loan) and *Miller* (treatment as a gift) are the existence of a written note, charging of interest, actual payment of interest, and the existence of a repayment schedule. Some of the practical pointers suggested in the article include charging AFR or higher interest, using signed notes, paying interest annually, reporting loans accurately on balance sheets and tax returns, securing the loan if practical, and enforcing formalities.

(4) **Regulations Provide That Non-Payment Risks ARE Considered in Valuing Transfers of Notes.** The general regulation for valuing the transfer of notes for gift tax purposes states that the value is the unpaid principal plus accrued interest, unless the evidence shows that the note is worth less (e.g., because of the interest rate or date of maturity) or is uncollectible in whole or in part. The regulation provides:

> The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus accrued interest to the date of the gift, unless the donor establishes a lower value. Unless returned at face value, plus accrued interest, it must be shown by satisfactory evidence that the note is worth less than the unpaid amount (because of the interest rate, or date of maturity, or other cause), or that the note is uncollectible in part (by reason of the insolvency of the party or parties liable, or for other cause), and that the property, if any, pledged or mortgaged as security is insufficient to satisfy it.

Reg. §25.2512-4.

The regulation's reference to the presumption that the note's value is the unpaid principal "unless the donor establishes a lower value" indicates that the regulation governs the valuation of a note that is *transferred* by a donor. It does not apply specifically in determining, for gift tax purposes, the value of a note that is *received* by the donor in a loan or sale transaction. The applicable regulation for that transaction would seem to be Reg. §25.2512-8, which addresses transfers for insufficient consideration, and that regulation gives no specific guidance about the valuation of notes.

(5) **Arguments that Non-Payment Risks SHOULD be Relevant in Valuing Notes in Loan Transactions.** Some commentators maintain that non-payment risks *should* be considered in valuing *notes received in loan or sale* transactions. *E.g.*, Paul Hood, *Galli v. Commissioner: The Perils of Intra-Family Loans, Following the Rules Saved this Taxpayer!*, LEIMBERG INCOME TAX PLANNING NEWSLETTER (June 18, 2025) ("Is the Tax Court's conclusion about IRC Sec. 7872 necessarily so for the fair market value standards for *transfer tax* purposes. I don't believe that the Congress did any such thing, and, if it did, it should've been tightly construed to only refer to the impact of the interest rate on whether the loan has a gift element, and not to simply find all intra-family notes or debt instruments that pay interest at the minimum applicable AFR are for fair market value and not gifts. The debtor's creditworthiness, repayment history, etc. still matter.")

(a) **Traditional Willing Buyer-Willing Seller Test.** Under the traditional hypothetical willing buyer-willing seller test generally used for transfer tax valuation purposes, all relevant factors that a hypothetical willing buyer and seller could know and would consider are taken into account. Under this test, intra-family transactions are often compared to commercial transactions, and in the commercial world, an unsecured note from a borrower with few funds and little income would be valued at less than face. As an example, if a parent loans $100,000 to an 18-year old who has little ambition, no income, and perhaps has had history of drug-use in return for an unsecured AFR note, the parent may have difficulty getting over the "bona fide loan test" hurdle. If that is satisfied, would a hypothetical lender have made that same loan and valued the note at its face amount?

(b) ***Frazee* and *Estate of True* Did Not Address Non-Payment Risks**. *Frazee* involved a sale for a secured note with a 7% interest rate that was above the §483(e) 6% rate but less than the AFR. The primary issue regarding the note was whether using an interest rate above the §483(e) rate should be valued at its face amount under the theory that §483(e) provides a safe-harbor for gift tax purposes. The entire discussion about the valuation of the note was the valuation impact of having an interest rate that was below the AFR. The case determined that using the §483(e) rate was not a safe-harbor for gift tax purposes. The case noted that §7872 was enacted in response to *Dickman v. Commissioner*, 465 U.S. 330 (1984), which held that interest-free loans resulted in a gift of the reasonable value of the right to use the loaned money. But §7872 went beyond *Dickman* "to provide comprehensive treatment of below-market loans for income and gift tax purposes." The court held that it applied beyond just loans of money and applied to some seller-financing. The court's statement that "Congress displaced the traditional fair market methodology of valuation of below-market loans" could be interpreted as an indication that §7872 usurps traditional valuation concepts when valuing notes received in loans or seller financing, but that sentence goes on to say "by substituting a discounting methodology," suggesting that it was referring to the valuation aspect dealing with a below-market interest rate. The court "welcomed" the IRS's approach of valuing the note by determining its present value under §7872, using the AFR rather than a

commercial market rate. There was no discussion whatsoever in the case about collection or non-payment risks, and the decision does not affirmatively say to ignore non-payment risks following the adoption of §7872 in valuing notes.

Similarly, *Estate of True v. Commissioner*, T.C. Memo. 2001-167, involved a buy-sell agreement that involved only time value of money issues in valuing a deferred payment right. The court determined that under a buy-sell agreement, a shift of the benefits and burdens of ownership of business interests occurred when notice was given of intent to sell even though payment of the purchase price was not to be received until six months later. The court determined that the deferred payment arrangement was considered to be an interest-free loan, and the value of the deferred payment right was determined under §7872. Again, there was no discussion about collectability or non-payment risks, and the court did not explicitly say to value the deferred payment right without regard to any non-payment risks.

On the other hand, deficiency notices related to the *Galli* Order did expressly raise questions about whether the terms were not reasonably comparable to the loans made between unrelated persons in the commercial marketplace and questions about whether repayment was intended or would be enforceable. The IRS explicitly took the position that the present fair market value of future payments must take into account the risk of non-payment and concluded that the failure to consider those risks resulted in undervaluing the note by $869,000. The court's reasoning did not address why §7872 required that non-payment risks should be ignored, but the result of the Order was clearly to value the note, which bore interest at the AFR, at its face amount and to ignore non-payment risks in valuing the note.

(c) **Private Letter Rulings Have Been Consistent In Considering Non-Payment Risks in Valuing Notes.** Private letter rulings issued after *Frazee* have ruled, consistent with *Frazee*, that the principles of §7872 apply in sales as well as money loan situations. Letter Rulings 9535026 & 9408018. However, both of those rulings were conditioned on (i) there being no indication that the note would not be paid according to its terms and (ii) the borrower's ability to repay the notes was not otherwise in doubt.

(d) **Conclusion.** From a taxpayer perspective, the *Galli* Order is helpful in concluding that a note received in a sale transaction that had interest at the AFR was valued at face despite IRS arguments that its value should be discounted because of non-payment risks. Other cases saying that notes should be valued under §7872 (*True* and *Estate of True*) had not involved whether the valuation should consider non-payment risks. This issue has been pursued by the IRS in various recent estate and gift tax examinations, and the IRS will likely continue to press this issue.

33. Tax-Affecting for Valuing S Corporations; Valuation Approach, *Pierce v. Commissioner,* T.C. Memo. 2025-29 (April 7, 2025)

a. **Basic Factual Background.** The case addresses the gift tax valuation of gifts of 29.4% interests and sales of 20.6% interests in an LLC by each of husband and wife. The LLC is taxed as an S corporation. The court evaluated appraisal reports by experts for the taxpayers and the IRS. Both experts valued the LLC under the income approach (discounted cash flow analysis) rather than under a market or assets approach because the primary value was as an income producing entity.

b. **Key Points.**

(1) **New Valuation Report During Gift Tax Examination.** The donor selected new counsel during the gift tax examination and the new law firm obtained a new valuation report, with a lower value than was reported on the gift tax return. The opinion observed that the value reported on the gift tax return is an admission against interest when it conflicts with a subsequent valuation position, but the admission is not conclusive and the trier of fact may determine what weight is given to the admission. The court found that cogent proof existed that the earlier reported values were erroneous.

(2) **Tax Affecting.** Cash flows were "tax-affected" to reduce earnings of the S corporation by a hypothetical entity-level tax. Both appraisers used same method of tax-affecting but disagreed as to the proper rate. "Under these circumstances, it is proper to apply tax affecting to Mothers Lounge's earnings. We emphasize that while we apply tax affecting here, given the unique setting at hand, we are not necessarily holding that tax affecting is always, or even often, a proper consideration for valuing an S corporation." (This analysis was similar to that in *Estate of Cecil v. Commissioner*, T.C. Memo. 2023-24, and *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101.)

(3) **Discount Rate for Discounting Cash Flows.** The discount rate (for discounting cash flows to present value) was determined using the "build-up method", which bases the cost of equity on the interest rate paid on government obligations and increases it to compensate for risks of the particular investment, including general risk of the stock market (market premium), risk associated with the size of the company (size premium), and unique risks associated with the company (company-specific premium). The only disagreement was over the company-specific premium. The company had many risks, well described by the taxpayer's appraiser, but the appraiser did not analyze each separate risk and the probability of that risk's occurring, and did not explain why a specific number (5%) was chosen as the company-specific premium. The court used the IRS's expert's lower company-specific risk premium. (Query whether applying those risks in determining anticipated cash flows would have been subject to less scrutiny? Indeed, the court concluded that it was not satisfied that the taxpayer's appraiser's "company-specific risk adjustment accounts for only risks that have not been considered elsewhere in the determination of Mothers Lounge's value.")

(4) **Terminal Value.** A terminal value was determined, reflecting the present value represented by the indefinite income stream beyond the projected future cashflows; the court resolved a difference of opinion between the appraisers regarding the residual growth rate (choosing to go with a growth rate based on the long-term GDP growth rate).

(5) **Nonoperating Assets.** Nonoperating assets were added to the discounted value of the cash flows. The court resolved a difference of opinion that arose about the amount of nonoperating assets, using the taxpayer's appraiser's lower estimate based on tying capital needs to sales rather than to assets of the company.

(6) **LOC and LOM Discounts.** Discounts for lack of control (5%) and lack of marketability (25%) were applicable.

(7) **Criticism of "Valuation Cafeteria" Approach in Court's Analysis.** The court's approach has been strongly criticized as a "valuation cafeteria," in which "the judge carefully evaluates each appraiser's work in each of the major components of a valuation opinion as if these component parts are homogeneous (they are not)…. A decision that an appraiser makes on one so-called "component part" in an appraisal assignment can and does, impact, often significantly, the results in other component parts, rendering attempted comparisons of even simple, numerical so-called component parts, e.g.. DLOC/DLOM, imbued with a false sense of accuracy solely because the answers are precise, i.e. percentages." Paul Hood, *Pierce v. Commissioner – At the Intersection of Valuation and Infidelity – It's About the Right Projections!*. LEIMBERG ESTATE PLANNING NEWSLETTER #3210 (June 2, 2025).

34. Assets of Delaware Domestic Asset Protection Trust Created by Michigan Resident Could Not Be Reached to Satisfy Michigan Judgment Against the Settlor-Beneficiary, *In the Matter of the CES 2007 Trust* (Del. Chancery Ct. Vice Chancellor Order Oct. 1, 2025, Magistrate Report May 2, 2025)

a. **Brief Summary**. A creditor sought to reach the assets of an irrevocable Delaware asset protection trust (the CES 2007 Trust) that had been created about a decade earlier by a Michigan resident at a time that Michigan did not have a domestic asset protection trust (DAPT) statute. The trust included the Grantor and others as discretionary beneficiaries. A creditor, holding a 2019 $14 million judgment from a Michigan court against the Grantor, sought to invalidate the CES 2007 Trust or its spendthrift

provision, arguing the trust was a sham designed to evade payment and that the Grantor acted as a de facto trustee by managing LLCs owned by the trust. The trust, created in 2007, held 90% membership interests in three Delaware LLCs that owned Michigan and Colorado real estate. The Grantor served as manager of the LLCs and as investment advisor to the trust with the authority to give directions regarding management and investment of the trust assets, while an institutional trustee retained sole discretion over distributions.

The Senior Magistrate of the Delaware Court of Chancery filed a Report recommending dismissal of the creditor's petition. The decision found that the trust satisfied Delaware's Qualified Dispositions in Trust Act requirements: it was irrevocable; had a spendthrift clause; included a qualified Delaware trustee; and validly received "qualified dispositions." Importantly, the Court declined to equate the Grantor's role as LLC manager with being a de facto trustee and refused to pierce the LLC veil.

The Magistrate's Report was subject to *de novo* review by the Vice Chancellor, who entered an Order on October 1, 2025, dismissing the case for lack of standing. (That Order can and likely will be appealed.) The Vice Chancellor raised the standing issue *sua sponte*. Although the Order dismissing the case did not turn on the DAPT issues, the Vice Chancellor did note that "the Report's analysis appears correct, but … [its] conclusions are technically advisory opinions."

The ruling by the magistrate is undergoing a de novo review by the Vice Chancellor. Subject to exceptions, it represents a notable affirmation of the viability of properly structured Delaware DAPTs. The decision reinforces the statutory integrity of properly structured Delaware DAPTs, even where the settlor is a discretionary beneficiary, exercises managerial control over trust-owned LLCs, and is not a resident of Delaware. However, the ruling does not address a possible argument that the out-of-state judgment should be enforced under the Full Faith and Credit Clause, nor does it address conflict of laws issues regarding the viability of a DAPT created by a resident of a state that did not have DAPT legislation when the trust was created, thus possibly being contrary to a strong public policy of the resident-state. *In the Matter of the CES 2007 Trust* (Del. Ch., C.A. No. 2023-0925-SEM, May 2, 2025).

b. **Basic Facts.**

(1) **Trust Formation.** The CES 2007 Trust was created in 2007 by a Michigan resident, nearly a decade before the creditor's claim arose. It was irrevocable, invoked Delaware law, and contained a standard spendthrift clause. The beneficiaries included the "Grantor's wife (if any), the Grantor's parents, and the issue of the Grantor's parents living from time to time." The Grantor was not excluded from the class of beneficiaries (i.e., as one of the issue of his parents).

(2) **Trust Structure.** The Trustee was a Delaware corporate trustee, later replaced by a successor corporate trustee (after a dispute arose regarding payment of the initial Trustee's past-due compensation). The settlor retained the role of "advisor" to give directions to the Trustee regarding "all matters relating to the management and investment of trust assets." The Trustee made all distribution decisions. The Grantor's brother served as trust protector with powers to replace the trustee. In addition to being a discretionary beneficiary of income or principal of the trust in the Trustee's "sole and absolute discretion," the Grantor held a testamentary limited power of appointment to appoint the trust assets at his death to anyone other than the Grantor, his estate, his creditors, or the creditors of his estate, thus causing the transfer to the trust to be an incomplete gift for gift tax purposes. In default of exercise of the power of appointment, at the Grantor's death the assets would pass to the Grantor's issue (with alternative provisions if he had no surviving issue).

(3) **Trust Assets.** The trust owned 90% interests in three Delaware LLCs (with 10% owned by South Dakota trusts). The LLCs owned real estate in Michigan and Colorado. The Grantor was manager of the LLCs.

(4) **Creditor Dispute.** A creditor, Can IV Packard Square, LLC, obtained a $14 million judgment in Michigan in 2019 after a failed business loan. It sought.

c. **Analysis in Magistrate's Report, May 2, 2025.**

(1) **Overview of Analysis.** The Magistrate recommended dismissal of the creditor's petition because the trust met the requirements of the Delaware DAPT statute. The creditor failed to affirmatively demonstrate that the Trustee was not qualified, that the Grantor was somehow a *de facto* trustee, or that the spendthrift provision should be invalidated under common law principles.

(2) **Delaware Qualified Disposition in Trust Act.** The Delaware DAPT statute (the Qualified Dispositions in Trust Act, 12 DEL. C. §§3570-76) requires:

a. The transfer must be a "qualified disposition," meaning a transfer to one or more trustees, at least one of which is a "qualified trustee";

b. The transfer must be to a qualified trustee, meaning (a) an individual other than the transferor who is a resident of Delaware or other trustee whose activities are subject to supervision of the State Bank Commissioner, the FDIC, or the Comptroller of the Currency, and (b) who maintains or arranges for custody in Delaware some or all of the property, maintains records on an exclusive or nonexclusive basis, prepares or arranges for the preparation of fiduciary income tax returns for the trust, or "otherwise materially participates in the administration of the trust";

c. The trust agreement must invoke Delaware law;

d. The trust must include a spendthrift provision; and

e. The trust must be irrevocable.

A qualified disposition to a qualified trustee may be attacked only in limited circumstances: (i) for pre-transfer creditors by showing it was a fraudulent transfer; and (ii) for post-transfer creditors, by showing actual intent to defraud such creditor.

(3) **Qualified Dispositions and Qualified Trustees.** The transfers to the trust (membership interests in LLCs) were valid "qualified dispositions" under Delaware law. The trustees—both the initial and successor institutional trustees—met the statutory definition of "qualified trustees." The creditor made various arguments to dispute that the transfer was a qualified disposition to a qualified trustee, summarized below.

(a) ***De Facto* Trustee; Trustee was Superfluous.** The creditor maintained that the Grantor's retention and exercise of control over the real property in the LLCs "undermines the role played by the trustees of the Trusts, rendering them not qualified and superfluous." The Magistrate responded that the trust assets were membership interests in the LLCs and as a member had no interest in specific LLC property. No facts were pleaded on which the court should pierce the veil of the LLC and treat the trust as owning the real property. The Magistrate found no facts showing the trust lacked economic reality or that the settlor had complete, unfettered control over trust assets.

(b) **"Materially Participated" Requirement.** Another of the creditor's arguments was that the trustee failed to meet the "materially participated in the administration of the trust" requirement because the trustee merely held membership interests in the LLC, and the Trustee was never intended to materially participate in the administration of the trust. The Magistrate responded that "[a]t most, the Amended Petition reflects that little administration was necessary for the Trust; for a trust holding solely membership interests in the LLCs, it is not difficult to understand and appreciate such dormancy." Even though the trustee's role was relatively passive, the Magistrate ruled this was sufficient where the trust primarily held LLC interests.

(c) **Trustee Directed as to Investments and Management.** The creditor also argued that the Grantor's role as investment advisor, with authority to direct the Trustee as to the investment

and management of trust assets "undermines the trustee's authority." The Magistrate replied that the Delaware statutes specifically authorize direction advisors. The creditor pointed out that does not explicitly authorize "a settlor to continue to manage, control, and operate a business," but the court said that was not necessary.

(d) **Grantor Dominion and Control.** Finally, the creditor argued that the Grantor "exercises near-complete dominion and control over the Trust, disregarding and failing (or refusing) to recognize its separate existence." The Magistrate answered that the trust had no direct interest in the LLCs' real estate, but merely owned membership interests in the LLCs. "To entertain the Petitioner's theory would require this Court to disregard the layers of business entities and ignore the LLC Act's and Act's clear legislative intent."

(4) **Other Statutory Requirements of the Delaware DAPT Statute.** The trust incorporates Delaware law, includes a spendthrift provision, and is irrevocable.

(5) **Common Law Invalidity.** The creditor argued the trust or its spendthrift provision should be voided under common law principles. *Kulp v. Timmons*, 944 A.2d 1023 (Del. Ch. 2002), stated that under common law principles, "our courts will not give effect to a spendthrift trust that has no economic reality and whose only function is to enable the settlor to control and enjoy the trust property without limitations or restraints, as was done before the trust was created." *Id.* at 1032. The two primary doctrines underlying such principle are public policy (if the trustee controls assets for his own benefit, unconstrained by any fiduciary duties) or merger (if the interests of the beneficiaries and settlors are identical). Neither are applicable.

d. **Vice Chancellor's Order, Oct. 1, 2025.** The Magistrate's Report was subject to *de novo* review by the Vice Chancellor, who entered an Order on October 1, 2025, dismissing the case for lack of standing. (That Order can and likely will be appealed.) The Vice Chancellor raised the standing issue *sua sponte*. The Order noted that the creditor complained that there had been various transfers of Properties back and forth between the debtor and LLCs that were owned 90% by the trust and that the debtor was the manager of the LLCs. The Order reasoned:

> Here, the Lender lacks any type of injury that could support standing. The Lender did not loan money to the Trust; the Lender loaned money to one of [the debtor]'s entities. The Lender complains that [the debtor] and the Companies transferred properties back and forth, but that did not affect the Trust, and the Trust's assets did not change. There is no connection between the Trust and any injury that may have resulted from the transfers. Nor is there any connection between the Lender and any of the supposed problems with the Trust that the Lender identifies.

Although the Order dismissing the case did not turn on the DAPT issues, the Vice Chancellor did note that "the Report's analysis appears correct, but … [its] conclusions are technically advisory opinions."

e. **Planning Considerations.**

(1) **Creditor Not Able to Reach Assets Even Though DAPT Created Under Laws of a Second State.** An important unresolved issue is whether a resident of a state that does not have a DAPT statute could create a DAPT under the laws of another state that does have a DAPT statute. Those were the facts of this case (other than the fact that Michigan adopted a DAPT statute after the 2007 Delaware trust was created), and the creditor was not able to reach the trust assets (so far – the case has been dismissed but it can and likely will be appealed). At a minimum, the case supports the enforceability of a Delaware DAPT even where the settlor resides outside Delaware. However, the case does not address either of two primary issues that arise regarding an out-of-state DAPT: (1) whether a foreign judgment must be enforced against the trust assets under the Full Faith and Credit Clause; and (2) conflict of laws principles (both of these issues are discussed below).

(2) **Entity Ownership & Control.** The Magistrate's Report (which the Vice Chancellor's Order views as correct, but technically an advisory opinion) affirms that a DAPT can own LLCs managed by the settlor without invalidating the trust. Trusts often own interests in LLCs that may involve the

settlor as a manager or in other ways; that is not at all unusual. However, planners should caution clients against self-serving or non-arm's-length transactions at the LLC level, as such conduct could provide grounds for veil-piercing in future cases.

(3) **Importance of Timing; Old and Cold Trust.** The trust's creation long before the creditor claim was important. Courts are more likely to respect DAPTs that are "old and cold" rather than formed in the shadow of liability. As an example of the helpfulness of having an old trust, Bankruptcy Code §548(e) imposes a ten-year look back period if the trust was created to hinder, delay, or defraud a creditor. Fraudulent transfers to DAPTs will not be respected, and creating a trust on the verge of a pending creditor claim being made can be a badge of fraud.

(4) **"Hybrid DAPTs"; SPATs.** Using what is sometime called a "hybrid DAPT" or a special power of appointment trust (SPAT) may be a better alternative for a settlor wanting to create a trust in which the settlor may possibly benefit as a beneficiary. Under a hybrid DAPT, the settlor would not be a named beneficiary of the trust, but the trust would give a third party the ability to add the settlor as a discretionary beneficiary at a later date. *See* Steve Oshins, *In the matter of the CES 2007 Trust: Delaware Court Says Domestic Asset Protection Trust Is Protected*, LEIMBERG ASSET PROTECTION NEWSLETTER #445 (May 14,2025) ("the settlor is almost never actually added if the structure is well planned"; "generally far superior to a regular DAPT for residents of jurisdictions that don't have a DAPT statute").

A SPAT does not include the settlor as a beneficiary but grants to a third power a nonfiduciary power of appointment to appoint trust assets to the settlor or to a trust for the settlor's benefit. *See e.g.,* Abigail O'Connor, Mitchell Gans & Jonathan Blattmachr, *SPATs: A Flexible Asset Protection Alternative to DAPTs*, ESTATE PLANNING (Feb. 2019). Either of those is more likely to be protected from claims of the settlor's creditors, especially if the settlor is never added as a beneficiary or if trust assets are never appointed to or for the benefit of the settlor.

(5) **Full Faith and Credit Clause.** The case did not address Full Faith and Credit issues when a settlor from a non-DAPT jurisdiction uses a trust in a DAPT state. No case has yet addressed whether a judgment in one state will be entitled to "full faith and credit" in an enforcement action against a DAPT in another state (a DAPT state) where the trust is located. A similar issue was raised, though, in *In the Matter of Cleopatra Cameron Gift Trust*, 931 N.W.2d 244 (S.D. 2019), which reasoned that the Full Faith and Credit Clause does not apply to the manner for *enforcing* judgments of another jurisdiction. That case addressed an attempt to enforce a California judgment for child support against a South Dakota trust in South Dakota. The South Dakota Supreme Court said the main issue is the constitutional Full Faith and Credit issue. It noted that the U.S. Supreme Court (*Baker by Thomas v. General Motors Corp*, 522 U.S. 222 (1998)) has recognized that a limitation on the Full Faith and Credit Clause is that the "time, manner, and mechanisms for ENFORCING judgments" (emphasis added) of the forum state can be applied (rather than of the other state that rendered the judgment). Justice Scalia's concurring opinion observed that the purpose of the Full Faith and Credit Clause is to make the judgment of "one State conclusive evidence in the courts of another State," but that despite the preclusive power of one state's judgment, it "can only be executed in [the forum state] as its laws may permit." The court also cited the RESTATEMENT (SECOND) OF CONFLICT OF LAWS §99 ("The local law of the forum determines the methods by which a judgment of another state is enforced"). The court concluded that the order to pay Cleopatra's child support obligation out of the trust is a matter of *enforcing* the support obligation judgment against her, and "the means of enforcing judgments does not implicate full faith and credit considerations." The creditor was not able to reach the trust assets.

(6) **Conflict of Laws Issues.** The case did not address conflict of laws issues when a settlor from a non-DAPT jurisdiction creates a trust governed by the laws of a DAPT state. A primary issue that has arisen in cases addressing DAPTs is the conflict of laws issue as to whether the law of the DAPT state where the trust is situsted or the laws of the debtor's state will apply.

(a) ***In re Huber***. For example, *Waldron v. Huber (In re Huber)*, was a bankruptcy case concluding that Washington (the debtor's state) had a strong public policy against asset protection for self-settled trusts and applied the law of Washington rather than Alaska. *In re Huber*, 2013 WL 2154218 (Bankr. W.D. Wash. 2013) (Washington real estate developer created Alaska asset protection trust in 2008 when he was aware of the collapsing housing market and that his prospects for repaying loans was fragile at best; trust was found to be a fraudulent transfer voidable under both §544(b)(1) [state law fraudulent transfers] and §548(e) [transfer made within 10 years of filing petition for bankruptcy to a self-settled trust or similar device if made with actual intent to defraud creditors]; trust also held invalid under conflict of laws analysis because even though the choice of law designated in the trust is upheld if it has a substantial relation to the trust considering factors such as the state of the settlor's or trustee's domicile, the location of the trust assets, and the location of the beneficiaries, in this case the trust had its most significant relationship with Washington and Washington has a strong public policy against self-settled "asset protection trusts," citing §270 of RESTATEMENT (SECOND) OF CONFLICT OF LAWS).

Section 270 of the RESTATEMENT (SECOND) OF CONFLICT OF LAWS states: "An inter vivos trust in movables is valid if valid under the law of the state designated by the settlor to govern the validity of the trust, provided that the application of its law does not violate a strong public policy of the state with which the trust has its most significant relationship." Section 273 of the RESTATEMENT discusses the same issue regarding immovables but does not include the strong public policy exception. The *Huber* opinion did not mention §273. Some commentators have strongly criticized the *Huber* reasoning. *See* Steve Oshins, *In the Matter of the CES 2007 Trust: Delaware Court Says Domestic Aset Protection Trust is Protected*, LEIMBERG ASSET PROTECTION PLANNING NEWSLETTER #445 (May 14, 2025.

(b) ***Toni I Trust v. Wacker.*** Another case that limited the effectiveness of an Alaska DAPT against a creditor from the settlor's state, but did not discuss the conflict of laws issues, is *Toni I Trust v. Wacker*, 413 P.3d 1199 (Alaska 2018). The facts are outrageously egregious, but the Alaska Supreme Court ultimately held that an Alaska statute cannot bar a Montana creditor from bringing a claim under Montana law against a Montana debtor over property located in Montana, just because the property had been assigned to an Alaska trust. The court held that the exclusive jurisdiction provision in the Alaska DAPT statute is unconstitutional. For a more detailed discussion of the *Toni I Trust* case, see Item 28.b. of Estate Planning Current Developments and Hot Topics (December 2019) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(c) **Other Cases.** For a discussion of other cases that have addressed the conflict of laws issue (and an excellent discussion of the *CES 2007 Trust* case and planning implications of the case) see Alan Gassman, Martin Shenkman & Jonathan Blattmachr, *In the Matter of CES 2007 Trust: Delaware Court Upholds Delaware Asset Protection Trust Owning Real Estate LLCs Managed by the Grantor/Beneficiary*, LEIMBERG ASSET PROTECTION PLANNING NEWSLETTER #452 (Aug. 20, 2025).

(d) **Strong Public Policy Issue; Uniform Trust Code §107.** The "strong public policy" issue is also addressed in section 107 of the Uniform Trust Code, which provides that the meaning and effect of the terms of a trust are determined by: (1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is *contrary to a strong public policy* of the jurisdiction having the most significant relationship to the matter at issue, or (2) in the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at issue.

(e) **Strong Public Policy Issue; Impact of Adoption of DAPT Statutes by Majority of States.** The adoption by a growing number of states of DAPT statutes and statutes providing protection from creditors of the donor in certain situations "moves this approach from the eccentric anomaly category to an accepted asset protection and transfer tax minimization

planning technique ... As more and more states enact DAPT statutes, the conclusion that a non-DAPT state has a "strong public policy against a DAPT trust seems less likely." David Shaftel, *Thirteenth ACTEC Comparison of the Domestic Asset Protection Trust Statutes* (updated through August 2022).

(f) **Uniform Voidable Transfers Act.** Comment 8 to §4 (which specifies transfers that are deemed voidable) of the Uniform Voidable Transfers Act discusses an example regarding a resident of a non-DAPT state that creates a DPT in a DAPT state, and suggests that a creditor of the resident could reach the trust (it says that the voidable transfer law of the resident state "would apply to the transfer." Some commentators view the Comment as stating that the transfer would be voidable *per se*. (The Comment does not use the term "voidable *per se*," but that seems to be the clear inference.)

This Comment has been subject to severe criticism of commentators. See e.g., George Karibjanian, Richard W. Nenno & Daniel Rubin, The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trust by Settlors in Non-APT States Are Not Voidable Transfers Per Se, 42 BNA TAX MANAGEMENT ESTATES, GIFT & TR. J. 173 (July 2017). The criticism has been met with an impassioned defense of the Comment by the Reporter of the UVTA. Kenneth Kettering, The Comments to the Uniform Voidable Transactions Act Relating to Self-Settled Spendthrift Trusts Are Correct, 42 BNA TAX MANAGEMENT ESTATES, GIFT & TR. J. 267 (September 2017).

(7) **Excess Settlor Control; De Facto Trustee Argument.** The Delaware court in *CES 2007 Trust* rejected the creditor's argument that the settlor was the de facto trustee and had control over all the trust assets, even though the settlor was the manager of the LLC owned by the trust. This is a common structure and the trust survived the attack in this case. But beware that the de facto trustee argument has been raised by various courts in recent years in various contexts.

A securities law violation case determined that the amount of disgorgement would be based in part on the income taxes that the defendants avoided by an offshore trust structure. *SEC v. Wyly*, 2014 WL 4792229 (S.D.N.Y. Sept. 25, 2014). The court determined that the settlors controlled all decisions for the trust, by expressing their "recommendations" to trust protectors who relayed those recommendations to the trustee, who *always* did as instructed. The court determined that the independent trustee exception to the grantor trust rules under §674(c) did not apply because the settlors in fact controlled all decisions. The court's analysis provides an insightful view of the dangers of creeping control by trust settlors over trust decisions.

> The Wylys, through the trust protectors who were all loyal Wyly agents, retained the ability to terminate and replace trustees. The Wylys expected that the trustees would execute their every order, and that is exactly what the trustees did.
>
> The evidence amply shows that the IOM trustees followed every Wyly recommendation, whether it pertained to transactions in the Issuer securities; making unsecured loans to Wyly enterprises, or purchases of real estate, artwork, collectibles, and other personal items for the Wylys and their children. The trustees made no meaningful decisions about the trust income or corpus other than at the behest of the Wylys. On certain occasions, such as the establishment of the Bessie Trusts [with their nominal foreign grantors], the IOM trustees actively participated in fraudulent activity along with the Wylys. The Wylys freely directed the distribution of trust assets for personal purchases and personal use. Because the Wylys and their family members were beneficiaries, the IOM trustees were thus "distributing" income *for* a beneficiary at the direction of the grantors—the Wylys.

Other more recent cases have raised similar concerns in various legal and tax contexts. *E.g.*, *United Food & Commercial Workers Unions v. Magruder Holdings, Inc.*, Case No. GJH-16-2903 (S.D. Md. Mar. 27, 2019) (ERISA case in which court looked to whether §678 applied to beneficiary's ability to withdraw assets as needed for health, education, support, and maintenance, but trustees never questioned whether withdrawn amounts were actually needed for those purposes; court reasoned that a "HEMS provision that exists only on paper cannot be said to restrict the power exercisable" by the beneficiary); *Estate of Moore v. Commissioner*,

T.C. Memo. 2020-40 (retained interest in assets contributed to family limited partnership under §2036 in part because decedent's relationship to his assets remained unchanged; two children were co-trustees of trust that was general partner of family limited partnership, but the "children typically did things because Moore asked them to, and giving them nominal 'power' was no different from Moore's keeping that power," and an implicit understanding existed that the decedent "would continue to use his assets as he desired and that his relationship with them changed formally, not practically.")

35. Portability Election Not Validly Made Because No "Complete and Properly Prepared" Estate Tax Return, *Estate of Rowland v. Commissioner*, T.C. Memo. 2025-76 (July 5, 2025)

a. **Brief Summary.** The Tax Court's decision in *Estate of Rowland v. Commissioner*, T.C. Memo. 2025-76, is a critical reminder of the strict compliance required for making a valid portability election under IRC § 2010(c). The court held that the surviving spouse's estate could not use the deceased spousal unused exclusion (DSUE) because the predeceased spouse's estate failed to timely file a "complete and properly prepared" estate tax return. Even though the return was filed within the two-year time window established by Rev. Proc. 2017-34 (for estates that are not otherwise required to file an estate tax return), it did not satisfy the requirement in that Revenue Procedure of filing a "complete and properly prepared estate tax return"—specifically, it lacked detailed valuations and misapplied the relaxed reporting rule for charitable and marital deduction property.

The return did not list values of properties passing to various individuals (other than the surviving spouse or charities). That is enough reason to conclude the estate did not file a "complete and properly prepared" return and therefore did not make the portability election.

Furthermore, valuation information should also have been provided for marital and charitable deduction property under the facts of this case. The regulations allow a relaxed reporting requirement for marital and charitable deduction property (merely listing assets that qualify for the marital or charitable deduction but not detailed valuation information about the assets, presumably because the value of the marital or charitable deduction assets would not affect the calculation of the DSUE amount) if an estate tax return is filed solely for the purpose of making the portability election. Reg. §20.2010-2(a)(7)(ii). However, that relaxed reporting requirement does not apply to marital or charitable deduction property the value of which "relates to, affects, or is needed to determine, the value passing from the decedent to a recipient other than the recipient of the marital or charitable deduction property." *Id.* In *Rowland*, the revocable trust directed 20% of her trust to a charitable foundation and one-quarter of the gross estate (including testamentary gifts) to her husband. The remainder was distributed to other beneficiaries, including grandchildren. Therefore, the value of marital or charitable deduction property impacted the amounts passing to other beneficiaries, and the special relaxed valuation rule did not apply.

The court also rejected the taxpayer's substantial compliance and equitable estoppel arguments. *Estate of Rowland v. Commissioner*, T.C. Memo. 2025-76 (July 15, 2025, Judge Urda).

b. **Basic Facts.**

- Fay Rowland died in 2016. Her gross estate was estimated at $3 million, under the $5.45 million exclusion, making an estate tax return otherwise unnecessary.
- Her revocable trust provides for a distribution of 20% of the trust estate to a charitable family foundation and "such amount … as when added to property to [the surviving husband] under my Last Will and Testament … will be equal to one-fourth of my gross estate." The remainder was distributed to other beneficiaries, including grandchildren.
- Her executor filed Form 706 late—on January 2, 2018—relying on the extended two-year timeline under Rev. Proc. 2017-34 but did not include fair market valuations for any individual assets – neither assets passing to the surviving spouse or a charity nor assets passing to other beneficiaries.

- The surviving spouse died later that same month (suggesting that the planners may have rushed to prepare the return for Fay's estate after finding the surviving husband was seriously ill and his estate needed the DSUE from Fay's estate to avoid having to pay estate tax).. His estate claimed the DSUE amount of $3,712,562 from Fay's estate, which the IRS later disallowed.

c. **Court Analysis.** The Court granted partial summary judgment in favor of the IRS.

(1) **Failure to Timely Elect Portability.** Fay's estate tax return was not timely filed, but her return was filed within the two-year window under Rev. Proc. 2017-34 for returns filed solely to make the portability election. However, the return did not satisfy the requirement in that Revenue Procedure of filing a "complete and properly prepared estate tax return." The estate tax return did not list any values of specific properties. As discussed below, a relaxed rule applies eliminating the requirement to list values of specific assets qualifying for the marital and charitable deduction, but Fay's return did not include values for *any* specific assets, including assets passing to beneficiaries other than the surviving spouse or a charity. That alone is enough to conclude that Fay's estate did not file a "complete and properly prepared" return, and therefore did not qualify for the two-year filing window in Rev. Proc. 2017-34.

(2) **Improper Use of Relaxed Valuation Rule.** The regulations do not require detailed valuation information for specific assets qualifying for the marital and charitable deduction property where such values do not affect other distributions, presumably because the value of the marital or charitable deduction assets would not affect the calculation of the DSUE amount). Reg. § 20.2010-2(a)(7)(ii) allows a relaxed reporting requirement for marital and charitable deduction property (merely listing assets that qualify for the marital or charitable deduction but not detailed valuation information about the assets) if an estate tax return is filed solely for the purpose of making the portability election. Reg. §20.2010-2(a)(7)(ii). However, that relaxed reporting requirement does not apply to marital or charitable deduction property the value of which "relates to, affects, or is needed to determine, the value passing from the decedent to a recipient other than the recipient of the marital or charitable deduction property." *Id.* Because Fay's plan allocated residue based on percentages that required knowing the value of the charitable and spousal shares, the relaxed valuation exception could not be used. The estate failed to provide detailed valuations and misapplied the relaxed rule.

(3) **No Relief via Substantial Compliance or Equitable Estoppel.** The Court rejected arguments that the return substantially complied or that IRS silence constituted misconduct supporting the estate's equitable estoppel claim. The court reasoned that the valuation reporting failures by the predeceased decedent's estate undermined the IRS's ability to assess the DSUE election, and no affirmative misconduct by the IRS was found.

d. **Planning Considerations.**

(1) **Example Attorneys and CPAs Use to Persuade Clients of the Necessity of Incurring Expenses for Carefully Preparing Returns to Make Portability Elections.** Perhaps the most significant takeaway from this case is that return preparers can point to this case as an example of why it makes sense for clients to incur the expenses necessary to have a "complete and properly prepared" estate tax return to make the portability election. *See* Ashlea Ebeling, *An Estate-Tax Mistake That Can Cost Millions*, WALL St.J. (Aug. 20, 2025).

(2) **IRS Will Scrutinize Portability Election Returns.** Another significant takeaway from this case is that when estate tax returns are filed using DSUE from a prior deceased spouse, the IRS will closely scrutinize the prior deceased spouse's estate tax return to assure that it is a "complete and properly prepared" return. The IRS may likely give the return much greater scrutiny to make sure that all technical filing requirements are satisfied than when examining a taxable return.

(3) **Statute of Limitations on Reviewing the DSUE Amount Remains Open.** No process exists to determine with finality that the prior return meets the "complete and properly prepared"

requirements to assure that the DSUE has been properly calculated. Code §2010(c)(5)(B) authorizes a review of the estate of a predeceased spouse to determine the DSUE amount available to the surviving spouse even though the estate tax statute of limitations has expired for the predeceased spouse's estate. Section 2010(c)(5)(B) provides:

> Notwithstanding any period of limitation in section 6501, after the time has expired under section 6501 within which a tax may be assessed under chapter 11 or 12 with respect to a deceased spousal unused exclusion amount, the Secretary may examine a return of the deceased spouse to make determinations with respect to such amount for purposes of carrying out this subsection.

The Tax Court has confirmed that the IRS can review the DSUE amount even though the statute of limitations has run for additional estate tax assessments against the predeceased spouse's estate. *Sower v. Commissioner*, 149 T.C. 279 (2017). *See* Chuck Rubin, Estate of *Sower - Audit of Predeceased Spouse Permitted for Purposes of DSUE Adjustment for Surviving Spouse's Estate*, LEIMBERG ESTATE PLANNING NEWSLETTER #2588 (Oct. 5, 2017).

Section 2010(c)(5)(B) and *Sower* address the determination of the DSUE *amount*, not the validity of the portability *election*. *Rowland* does not directly address whether the *election* can be questioned (because of the failure to file a "complete and properly prepared" return) even though the period of assessment of estate taxes has run against the predeceased spouse's estate, because the surviving spouse died very shortly after the predeceased spouse's return was filed (late, but within the extended relief period).

A way to accelerate the limitations period may be for the surviving spouse to make substantial gifts using the DSUE amount. (Gifts must use the DSUE before using the donor's own exclusion amount. The preamble to the final regulation reminds that the portability final regulations require that "any DSUE amount available to the decedent for [a] calendar period is deemed to be applied to the decedent's gifts before any of the decedent's BEA is applied to those gifts (citing Reg. §§20.2010-3(b) & 25.2505-2(b)). Preamble to Final Regulation at 6). Example 4 of the final regulation reiterates that result. Reg. §20.2010-1(c)(2)(iv), Ex. 4.) If the surviving spouse reports a gift making use of particular DSUE amount, once the limitations period has run on asserting additional gift tax for that gift, that DSUE amount will have been successfully utilized. If the gift is only made to utilize the available DSUE amount, however, the IRS may in reviewing the surviving spouse's estate tax return (or future gift tax returns) take the position the DSUE amount was lower (or nonexistent) and that if the DSUE is nonexistent, the prior gift had used the donor's own exemption amount. To assure that the period to review the DSUE amount has closed, the gift presumably would have to be sufficient to utilize all the donor's available gift exclusion amount (including the DSUE amount).

(4) **Some Portability Returns Require Full Valuation.** When a decedent's estate plan includes percentage-based bequests or residuary clauses tied to the gross estate, the value of charitable or marital deductions may affect other distributions. In such cases, relaxed reporting is inapplicable, and full, itemized valuation must be provided to have a "complete and properly prepared estate tax return on which the portability election may be made—even if the estate falls below the filing threshold.

(5) **Best Practice**: Consider preparing the Form 706 with the same rigor as if estate tax were due, regardless of whether it is filed solely to elect portability. The estate will need to assemble the valuation information in any event to support the basis adjustments under §1014 for estate assets. Including valuation information for specific assets on the estate tax return takes more time and expenses, so the planner must weigh whether to include detailed valuation information (especially if the first decedent's estate may be reluctant to file any estate tax return at all). But valuations should be thorough and schedules complete if the estate plan includes residuary gifts or formulas based on values passing to a surviving spouse or to charity. The extent to which a future court would overlook foot-faults under a substantial compliance doctrine is unclear; the *Rowland* court refused to apply the substantial compliance doctrine on the facts of that case (though there were very substantial lapses in the required information in *Rowland*).

(6) **Timeliness Is Not Enough.** Filing within the time allowed by Rev. Proc. 2017-34 (or now Rev. Proc. 2022-32, which provides a 5-year window), if an estate does not otherwise need to file an estate tax return, does not excuse failure to comply with the substantive "complete and properly prepared return" requirement. Both timeliness and content are required to qualify for the five-year relief provision.

(7) **Percentage of Estate to Charity or Spouse Provisions.** It is not unusual for an estate plan to leave some percentage of the value of the estate to a charity or a surviving spouse. In that situation, the values passing to others depends on the values passing to the spouse or charity, so the relaxed valuation rule for "portability returns" would not apply, and valuation information must be listed for all assets, including those passing to a spouse or charity, in order to have a "complete and properly prepared" return on which the portability election may be made.

(8) **High Risk of Tax Liability.** Disallowed DSUE elections can result in substantial estate tax liability for the surviving spouse's estate. In *Rowland*, the loss of the DSUE led to an added tax of approximately $1 million.

(9) **Portability Should Always be Discussed with Decedents' Estates.** Attorneys should educate fiduciaries early in the estate administration process about the implications of portability and ensure compliance with all requirements, particularly when complex estate planning structures are involved.

36. Compensatory Split Dollar Arrangement; Complex Trust Structure Does Not Mask Split Dollar Nature of Life Insurance Arrangement, *McGowan v. U.S.,* 136 AFTR 2d 2025-5113 (6th Cir. July 9, 2025)

a. **Brief Summary.** The Sixth Circuit's decision in *McGowan v. United States*, No. 24-3228 (July 9, 2025), addressed the federal income tax consequences of a split-dollar life insurance arrangement implemented by a closely held dental corporation and its sole shareholder-employee, Dr. Peter McGowan. The court upheld the IRS's position that the arrangement fell squarely within the scope of Reg. §1.61-22 (the "split-dollar regulation"), requiring McGowan to include the full economic benefit of the policy in his income and disallowing the corporation's deduction of premium payments. The interposition of a convoluted trust arrangement in the split-dollar arrangement did not preclude application of the regulation.

The life insurance was purchased under a convoluted arrangement trust arrangement with the company contributing money to two subtrusts for paying policy premiums. The "DBT" subtrust purchased the policy, and the company contributed money for the base premium to the DBT subtrust. The company also contributed money for paid-up additions to the policy to the "RPT" subtrust, which loaned the money to the DBT subtrust so that it could invest those amounts in the policy's cash value. The effect of the convoluted arrangement was that McGowan would receive the policy or its cash surrender value (after repaying the loan) if the company chose not to renew the arrangement or ceased paying premiums. The company had the right to "immediately remove" the trustee "for any reason."

In particular, Reg. §1.61-22(b)(2)(i), governing compensatory split-dollar arrangements, applies to arrangements between an owner and a non-owner of a life insurance contract that satisfied several other elements. McGowan argued that the company did not own the contract, so the arrangements was between two non-owners and the regulation would not apply. The court disagreed, reasoning that another regulation treats an employer as an owner if the policy is held by a "welfare benefit fund," and the RPT subtrust qualified as such a fund. Also, the substance over form doctrine would treat the subtrust arrangement as an "economically meaningless" interposition, and having an ostensibly independent trustee did not make a difference because the company could replace the trustee at any time. Under the regulations, the employee (McGowan) was required to include "the full value of all economic benefits" in his taxable income, and the company was precluded from deducting premium payments.

The court further confirmed the split-dollar regulation's validity under the post-*Loper Bright* judicial review framework, concluding that the plain language of the Internal Revenue Code provided sufficient statutory authority.

Though the IRS prevailed overall, the court preserved the Sixth Circuit's prior decision in *Machacek v. Commissioner* (2018), which characterized benefits from certain split-dollar arrangements as shareholder distributions rather than compensation. Based on that precedent, McGowan was entitled to a partial refund due to the IRS's erroneous taxation of the economic benefit at ordinary income rates rather than dividend rates. Nonetheless, the court strongly signaled *Machacek*'s likely future demise in light of *Loper Bright* and statutory interpretation principles. *McGowan v. U.S.,* 136 AFTR 2d 2025-5113 (6th Cir. July 9, 2025, Opinion by Judge Readler).

b. **Factual Summary.** Dr. McGowan, a Toledo-area dentist and sole shareholder of a C corporation, implemented a complex split-dollar insurance arrangement known as the "Plan," which operated through a Benefits Trust Agreement forming two subtrusts:

- **Death Benefit Trust (DBT):** Owned a whole-life insurance policy on McGowan's life. The Company contributed $37,222 annually to the DBT to fund the base premium.
- **Restricted Property Trust (RPT):** Received up to $12,778 annually from the company, The RPT loaned the money to the DBT so that it could invest those amounts in the policy's cash value The RPT held a security interest in the policy's cash value.

Three potential outcomes were contemplated:

1. If McGowan died during the Plan term, the death benefit would go to his wife.
2. If the company declined to renew after five years, the policy transferred to McGowan.
3. If the company ceased paying premiums mid-term, the DBT would surrender the policy for cash, which would be transferred to RPT in satisfaction of its security interest, and the RPT would donate to the Toledo Zoo—a charity selected by McGowan.

Despite the formal trust structure, the Company retained broad powers, including the ability to unilaterally remove the trustee at any time.

c. **Summary of the Court's Analysis.** The court conducted de novo review and affirmed summary judgment for the IRS, but concluded that McGowan was entitled to a refund because the economic benefit should have been taxed to McGowan as a dividend at capital gains rates rather than as compensation. Key holdings included:

(1) **Application of Split-Dollar Regulation:** The arrangement satisfied all elements of Reg. § 1.61-22(b)(2)(i),the regulation governing compensatory split-dollar arrangements, including the requirement that the arrangement be "between an owner and non-owner of a life insurance contract" (as well as other elements that were satisfied. McGowan argued that the company did not "own" the policy, so the arrangement was between two non-owners and the regulation would not apply. The court disagreed, reasoning that another regulation treats an employer as an owner if the policy is held by a "welfare benefit fund" (Reg. §1.61-22(c(1)(iii)(C)), and the DBT is a welfare benefit fund as defined in §419(e)(1). Also, the substance over form doctrine would treat the subtrust arrangement as an "economically meaningless" interposition, and having an ostensibly independent trustee did not make a difference because the company could replace the trustee at any time. Under the regulations, the employee (McGowan) was required to include "the full value of all economic benefits" in his taxable income, and the company was precluded from deducting premium payments.

(2) **Substance over Form; Looking Through Subtrust Arrangement:** The taxpayer argued that the form of the transaction (under which the company did not own the policy) should be respected because "'[form] *is* 'substance' when it comes to law" (quoting *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779, 782 (6th Cir. 2017). The responded that the regulations "treat a

welfare fund as synonymous with the employer. "[W]hile taxpayers are free to arrange their affairs to minimize taxes, they must do so in real ways-ways that give a transaction economic teeth and do not merely place tax-avoiding labels on tax-owing transactions)quoting Billy F. Hawk, Jr., GST Non-Exempt Marital Tr. v. Commissioner, 924 F.3d 821, 825 (6th Cir. 2019). The form embraced by the taxpayers "Largely amounts to the interposition of an economically meaningless subtrust. Arranging matters in this way does not defeat the Company's ownership rights over the Policy." The court disregarded the nominal independence of the trusts and trustee, concluding that the company retained effective control (noting that the company could replace the trustee "at any time and for any reason").

(3) **Gross Income Inclusion:** The employee must include in taxable income the "full value of all economic benefits," which the regulation defines as including "[t]he among of policy cash value to which the non-owner has current access." Reg. §1.61-22(d)(1)-(2). The court rejected the argument that McGowan lacked "current access" to the policy's cash value, reasoning that the regulation expressly defines "current access" in a counterintuitive manner to include "future rights,." Reg. §1.61-22(d)(4)(ii), and McGowan "several such current or future rights": his right to receive the Policy upon the Company's nonrenewal, his right to designate the beneficiary of the Policy's death benefit, and his right to designate the charity potentially receiving the cash value." enjoyed . "future rights" to cash value—such as directing a charitable donation—constitute taxable economic benefits under the regulation.

(4) **Denial of Corporate Deductions:** The split-dollar regulation prohibits the employer from taking deductions for its premium payments. Reg. §1.61-22(f)(2)(ii). The taxpayer argued that the regulation is invalid under *Loper Bright,* but the court concluded that the regulation "comports with [its] independent reading of the Internal Revenue Code," citing §61, §162(a), and §§419(a). The company sought to deduct the premiums under §162(a) as "ordinary and necessary expenses paid ,,, in carrying on a trade or business." The company alleged two business reasons for the Plan, (1) business continuity and (2) motivating McGowen to stay with the company. The court disagreed, finding that "the Plan did not 'compensate, incentivize, and retain key employees,' but instead formed an 'investment' and 'estate planning … vehicle[] for the sole benefit of the owners of the company" [quoting from *Curcio v. Commissioner*, 689 F.3d 217, 226 (2d Cir. 2012)].

(5) ***Machacek* and Refund.** At various points, the parties' briefs mentioned *Machacek v. Commissioner*, 906 F.3d 429 (6th Cir. 2018), in which the court had previously ruled that a compensatory split-dollar arrangement between a shareholder-employee and his employer should be taxed as if the taxpayer received a shareholder distribution, which meant it would taxed as a dividend at capital gains rates rather than at ordinary income rates as compensation. The court acknowledged tension with its prior *Machacek* decision, noting that its "sun may soon set" because the regulation underlying the *Mahacek* holding is suspect under a *Loper Bright* analysis. However, the court left it intact (because no party requested its reconsideration), thus allowing McGowan a partial refund based on dividend-rate treatment.

d. **Planning Considerations.**

(1) **Significance of Foreboding of Reversal of the *Machacek* Result.** The *Machacek* case was quite surprising, and it has been roundly criticized. Perhaps the most significant aspect of this case is its foreboding that the Sixth Circuit will reverse course from the position that in took in *Machacek* that benefits arising from a compensatory split dollar agreement with a shareholder-employee will be treated as shareholder distributions rather than as compensation. The court pointed to a regulation, to the fact that courts can differentiate payments tied to stock ownership from payments tied to services, to the IRS's non-acquiescence, to criticism of tax academics that "*Machacek* completely missed the boat," and ("most damning of all") to a Tax Court case joined by all sixteen then-active Tax Court judges that the court was "unable to embrace the reasoning or result of the Sixth Circuit's opinion in Machacek." *De Los Santos v. Commissioner*, 156 T.C.

120, 130 (2021). The court could not have been clearer about what it will do when faced with that issue in the future.

(2) **Scrutiny of Split-Dollar Arrangements.** IRS and courts will examine the **substance** of life insurance arrangements—especially where charitable components or complex trust structures are used—to ensure they are not merely personal wealth-transfer vehicles masquerading as business plans. Artificial trust layers used to hide the employer's position of owning and controlling the life insurance policy (to support an argument that the split dollar regulations would not apply) may be viewed as lacking economic substance.

(3) **Charitable Designations Do Not Avoid Income Inclusion.** Naming a charity as a contingent recipient of a policy's cash value does not negate income tax consequences when the employee retains control or designates death benefit recipients.

(4) **Use of Trusts Does Not Shelter Economic Benefits.** Even when formal ownership resides with a trust, employer control (such as the ability to replace trustees or amend trust terms) can lead to attribution of ownership and trigger income inclusion under split-dollar rules.

(5) **Deductibility Must Be Supported by Real Business Purpose.** Deductions under § 162(a) require more than tax efficiency. When insurance premiums primarily benefit the shareholder-employee or facilitate estate planning, they are unlikely to qualify.

(6) **Be Aware of Shifting Judicial Interpretations Post-*Loper Bright*:** Although *McGowan* preserved *Machacek*, it openly cast doubt on its statutory grounding. Estate planning structures that rely on *Machacek* for dividend treatment may soon face judicial reversal or IRS challenge.

37. GRAT Examinations Involving Valuations and Substitution Transactions for Grantor Notes, *Elcan v. Commissioner,* Tax Court Docket No. 3405-25 (Petition filed March 14, 2025)

a. **Brief Summary.** The grantor (husband and wife made the split gift election so they were both treated as donors) created GRATs and subsequently exercised substitution powers various times to obtain cash from the GRATs and at other times to re-acquire general partnership interests and S corporation stock that had been contributed to the GRATs. Notes from the grantor received by the GRATs in the substitution transactions were subsequently distributed to the grantor to satisfy required annuity payments. (The final annuity payment could not be fully satisfied with the remaining assets in the GRAT.) The IRS issued deficiency notices to each spouse for $306,929,994 gift tax and $61,385,999 penalties, for total deficiencies of over $736 million.

The notices of deficiency stated that the initial gifts to the GRATs were taxable gifts in their entirety because the grantor's retained annuity interests were not qualified interests under §2702. Alternatively, if the retained interests are determined to be qualified interests, the transfers of the grantor's notes to the GRATs in substitution transactions in which the grantor re-acquired partnership interests and stock that had been contributed to the GRATs were taxable gifts. The notices did not state why the retained interests were not qualified interests under §2702 or why the notes given to the GRATs in the substitution transactions were taxable gifts. Twenty percent accuracy-related penalties were assessed under §6662 because the underpayment was due to negligence or disregard of the rules and regulations.

The IRS's Answer was filed July 9, 2025; it gives no further insight as to the rationale for the gift conclusions in the deficiency notices. *Elcan v. Commissioner*, Tax Court Docket No. 3405-25 (Petition filed March 14, 2025).

b. **Basic Facts.**

- GRAT I and GRAT II were created on Feb. 20, 2018 and May 22, 2018, respectively. Shares of a Delaware S corporation (Frisco), an investment holding company, and units of a general partnership (Hercules), an investment holding company, were transferred to the GRATs. The values of the interests in Frisco and Hercules transferred to the GRATs collectively were $687,503,860. The GRATs provided for two annual annuity payments, described as specified

percentages of the values transferred to the GRATs. The annuity payments from GRATs I and II totaled $721,624,342.13.

- The values of the Frisco shares transferred to the GRATs were valued by appraisal and the values of the Hercules units were determined based on the average of the high and low trading prices of the publicly held stock owned by Hercules on the transfer dates. (The same valuation method was used to determine all transfers to and from the GRATs and from GRAT III, described below.)
- The grantor substituted a note for $1.27 million from GRAT II on July 13, 2018, and substituted notes in the collective amount of $852,742,730.49 for the interests in Frisco and Hercules that had been transferred to each of GRAT I and GRAT II on August 15, 2018.
- All the notes used in the transfections with the GRATs bore a commercial interest rate (Prime + 1%).
- The substitution of notes for the units and stock in GRATs I and II had the effect of leaving a net of $852,742,730.49 - $721,624,342.13, or $131,118,388.36, plus interest on the notes, that would remain at the termination of the GRATs to pass to the GRAT remaindermen without further gift taxes.
- Shares of Frisco (slightly more than the number contributed to GRATs I and II) and units of Hercules (same number as contributed to GRATs I and II) were contributed to GRAT III on August 15, 2018.
- Substitution powers were exercised to substitute notes (Prime + 1%) for cash transfers from GRAT III (in amounts ranging from about $1.2 million to almost $1.5 million) on October 15, 2018, Jan. 10, 2019, April 10, 2019, and July 6, 2019. (Observe that some of those were close to the grantor's income tax estimated payments dates.)
- On May 12, 2020, the grantor exercised her substitution power (1) to acquire all of the Frisco shares and some of the Hercules units from GRAT III in return for a $360,303,240.73 note and (2) to acquire additional units of Hercules in return for a $200,000 note.
- The first annuity payment, due on August 20, 2019, was satisfied by transferring some of the grantor's notes and some of the Hercules units to the grantor. The second annuity payment, due on August 15, 2020, was satisfied in part by transferring all the remaining assets of GRAT III to the grantor (some notes and units of Hercules). The entire second annuity payment could not be satisfied fully, and no remainder was left in GRAT III to pass to remainder beneficiaries.
- The grantor filed a 2018 gift tax return that made the split-gift election.
- The IRS mailed notices of deficiency on December 18, 2024, to the grantor and her husband, and they filed a Petition with the Tax Court on March 14, 2025. The IRS filed its Answer on July 9, 2025; the Answer provided no further explanation of the IRS's positions.

c. **Notices of Deficiency.** On December 18, 2024, notices of deficiency were mailed to grantor and her husband reporting gift tax deficiencies by the grantor and her husband in the aggregate amount of $613,859,989 and under-valuation penalties of $122,771,998, for total deficiencies of $736,631,987.

d. **Rationale for Deficiencies**. The notices of deficiencies gave very little reasons for the determination of the tax deficiencies. They gave two summary reasons: (1) the transfers to the GRATs I, II, and III was not made in returns for qualified interests under §2702 (without any explanation of why they were not qualified interests); and (2) alternatively, that the transfers of the grantor's notes to the GRATs in substitution transactions in which the grantor re-acquired interests in Frisco and Hercules that had been contributed to the GRATs were taxable gifts.

Twenty percent accuracy-related penalties were assessed under §6662 because the underpayment was due to negligence or disregard of the rules and regulations.

e. **Taxpayers' Motion for Partial Summary Judgment, Filed Oct. 1, 2025.** The taxpayers filed a motion for partial summary judgment on October 1, 2025. The motion described in detail the relevant facts of the funding and operation of the three GRATs (including the exercises of substitution power and the uses of grantor-notes to satisfy annuity amounts). The motion makes three major points in response to the contention in the Notice of Deficiency that the annuity interests were not "qualified interests" under §2702:

(i) the annuities were "qualified interests" under the unambiguous provisions of § 2702(b)(1);

(ii) given the unambiguous definition of a "qualified interest" under § 2702(b), the additional "qualified interest" requirements imposed by Treas. Reg. § 25.2702-3 are (i) irrelevant to determining whether Trisha's retained annuity interests were "qualified interests," and (ii) invalid under *Loper Bright* and related case law; and

(iii) the GRATs satisfied the "qualified interest" requirements of Treas. Reg. § 25.2702-3.

(1) **Annuities Constituted "Qualified Interests."** Section 2702(b) describes three different ways an interest can meet the definition of a qualified interest. The first is an interest that is a fixed right to receive fixed amounts payable no less frequently than annually. The IRS conceded the GRATs satisfied that requirement, so "no further analysis is required."

(2) **Additional Regulatory "Qualified Interest" Requirements Are Irrelevant and Invalid under *Loper Bright*.**

(a) **Regulations Cannot Override Unambiguous Statute.** Even under the *Chevron* analysis that applied prior to *Loper Bright*, "where the statute is unambiguous and the intent of Congress is clear, the statute must control the legal analysis. Various statements from the Tax Court n *Varian Medical Systems & Subsidiaries v. Commissioner*, 163 T.C. 76 (2024), reiterate that regulatory provisions can override clear statutory provisions, quoting several Supreme Court cases: "self-serving regulations never 'justify departing from the statute's clear text'"; "w]here . . . the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation"; and "Respondent's regulation . . . cannot change the result dictated by an unambiguous statute."

[**Observation:** The opening line of a very recent Eighth Circuit Court of Appeals case very concisely emphasizes this important principle: **"Statutes trump regulations."** *3M Company, and Subsidiaries v. Commissioner*, Circuit Ct. No. 23-3772 (Oct. 1, 2025) (emphasis added).]

(b) **The Regulations Are Interpretive Regulations That Erroneously Interpreted §2702 and Under *Loper Bright,* Are an Impermissible Interpretation of §2702 And Are Invalid.** There is no statutory authority for regulations to implement §2702 (unlike in §2704), but the §2702 regulations are interpretive regulations issued under the general authority of §7805(a). They are valid only if they are the "best reading" of the statute. The additional requirements in the GRAT regulations are an impermissible interpretation of §2702 and the regulations are invalid because (i) they are inconsistent with the plain text of §2702(b), (ii) the requirements in Reg. §25.2702-3 are inconsistent with §2702(b), and (iii) those requirements are inconsistent with the legislative history and purpose of §2702(b) (which were to prevent the annuity from being overvalued when the trust is funded and to assure the annuitant actually receives assets with a value not less than the amount to which she was entitled to receive under the trust instrument). Reg. §25.2702-3(b)(1) and (d)(6), which prohibit a GRAT from issuing its note in satisfaction of annuity amounts, are entitled to even less deference under the Supreme Court "change in position" doctrine because they were not adopted until eight years after the initial GRAT final regulations were issued.

In addition, the regulatory requirements in Reg. §25.2702-3 are inconsistent with §2512, which says that gifts are valued on the date of their transfer. Events that postdated the funding of the GRATs (such as the reacquisition of assets using substitution powers and the GRATs' satisfaction of annuity amounts with notes they acquired from the grantor) cannot be

used to determine the values of gifts under §2512. Furthermore, those events are not inconsistent with the regulations, which only require that the trust agreement prohibit certain events, and the trust agreements contained all of those restrictions.

The Tax Court has previously invalidated regulations that impermissibly disregard Congress's direction. *E.g. Walton v. Commissioner*, 115 T. C. 589, 595 (2000).

(3) **GRATs Satisfy the "Qualified Interest" Requirements of Reg. §25.2702-3.** The distribution of the grantor's notes in satisfaction of annuity amounts did not violate Reg. §25.2702-3(b)(1) and (d)(6), which prohibit a GRAT from issuing its note in satisfaction of annuity amounts. "No notes were issued by any of the trusts to satisfy Trisha's retained annuity interests under Treas. Reg. §25.2702-3(b)(1)."

f. **Planning Considerations.**

(1) **Two Recurring GRAT Examination Issues.** The IRS appears to be examining a number of GRAT transactions, involving both (1) valuations of assets contributed to GRATs and (2) substitutions for notes with grantor-notes. One observer (not a party in the case) has described *Elcan* as "part of the IRS's crusade." Other planners have noted that the IRS has made and is making these arguments in various pending IRS examinations.

(2) **GRAT Valuation Examinations.** The *Elcan* examination does not involve questioning the value of the assets contributed to the GRATs (the Answer filed by the IRS in *Elcan* agreed to the values reported for the contributions to the GRATs). However, there have been various examinations of GRATs involving valuations, and the IRS sometimes takes a position similar to its position in CCA 202152018 that treated a GRAT annuity as not being a qualified interest because of the undervalued appraisal used to determine the annuity amounts that were paid by the GRAT over its two-year term. Accordingly, the donor was 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 donor's retained annuity payments.

The CCA analogized to *Atkinson v. Commissioner*, 115 T.C. 26 (2000), *aff'd*, 309 F.3d 1290 (11th Cir. 2002), which denied an income tax charitable deduction for the creation of a charitable remainder annuity trust because of the manner in which the trust was operated (no annuity payments were actually made), even though the agreement itself met the technical requirements for CRATs.

CCA 202152018 reasoned that the result was appropriate because of the donor's "deliberately using an undervalued appraisal." Perhaps the IRS concern in this CCA was not so much with the appraised *amount* but with the *process*. The donor appeared 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). The case underlying that CCA is currently in litigation.

Similarly, the CCA reasoned that basing the annuity payments on an undervalued appraisal was an "operational failure" that resulted in Donor not having retained a qualified annuity interest under §2702.

(3) **GRAT Examinations Regarding Substitutions and Grantor Notes.** Substitutions for notes and using the grantor's notes to satisfy annuity payments have also been a target of various gift tax examinations (including *Elcan*). If notes are substituted for GRAT assets using inflated values of GRAT assets, the IRS would certainly be expected to treat the excess value as an additional gift (which would be a prohibited additional contribution to the GRAT and which might result in the contribution being treated as held by the trustee as a constructive trustee for the grantor). However, when GRAT assets are valued appropriately (and in this case they were based on appraisal of the Frisco stock and on the basis of the actual values of publicly traded stock held by Hercules), the substitution transaction is merely an investment decision (the trustee must determine that it is receiving "an equivalent value").

(a) **Does Not Violate Regulation.** Using grantor notes held by the GRAT to satisfy annuity payments does *not* violate the prohibition in regulations prohibiting a GRAT from "issuing a note, other debt instrument, option, or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation." Reg. §25.2702-3(d)(6). *See also* Reg. §25.2702-3(b)(1)(i) ("Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount does not constitute payment of the annuity amount"). In *Elcan*, none of the three GRATs "issued a note" in satisfaction of annuity payments. Instead, the GRAT used some of its assets (notes payable to it) to satisfy the annuity payments.

(b) **Commentator Support.** The taxpayer's Petition quotes an article by Carlyn McCaffrey for support of the position that using notes from another party (including the grantor) to satisfy annuity payments does not violate the prohibition in the regulations from the GRAT issuing its own note to satisfy annuity payments. The petition quotes the article as follows.

> The prohibition against the "issuance" of a note or similar financial arrangement does not prevent the use of notes issued by other persons to satisfy the payment obligation. *For example, a note issued by the grantor's spouse, by another trust, or even by the grantor would not violate this prohibition. The trustees of the GRAT might acquire such a note by selling some or all of the GRAT's assets to the issuer of the note*. (emphasis added in the petition). See e.g., C. McCaffrey, "The Care and Feeding of GRATs – Enhancing GRAT Performance Through Careful Structuring, Investing and Mentoring."

(c) ***Loper Bright* Challenge.** Furthermore, the regulation itself might be attacked on *Loper Bright* grounds as not being the "best reading" of the statute.

(4) **IRS Facing Political Challenges to Its "Aggressive and Novel Positions" in GRAT Audits and Litigation.** Written questions have been submitted to Donald Korb in proceedings in the Senate Finance Committee regarding his confirmation of IRS Chief Counsel. Some of those questions have expressly addressed positions that the IRS has been taking in audits and litigation involving GRATs. Senator Cornyn (R-TX) asked:

> Legislative proposals which would curtail GRATs have been introduced but never passed into law. The IRS under the last Administration instead pursued audits and litigation to impose requirements and standards not written in the statute or Treasury regulations.
>
> Do you agree the IRS must follow Treasury's regulations consistent with statute and not use audits or litigation to impose novel tax theories, including in cases regarding GRATs?
>
> Answer: I believe that staff at both the Treasury and IRS must follow the law as written. Further, the IRS should not place unnecessary regulatory burdens on any taxpayers through audit or litigation. If confirmed, I look forward to working with you on this matter.

Senator Daines (R-MT) asked:

> I have heard from constituents that during the Biden administration, the IRS took aggressive and novel positions challenging the use of grantor retained annuity trusts ("GRATs") driven by staff's political ideologies. It is my understanding that these positions are contrary to both the clear wording of section 2702, the statute by which GRATs are sanctioned, and the interpretive regulations issued by the Treasury Department under that statute.
>
> If confirmed, will you and your staff commit to enforcing the tax code by applying the laws as written by Congress?
>
> If confirmed, will you and your staff commit to reviewing from a fresh perspective those pending matters where the IRS is challenging the use of GRATs, to ensure that the IRS personnel in charge are correctly applying I.R.C. § 2702 and its regulations as those provisions were written and not imposing their own views on what the law should be?
>
> Answer: I believe that staff at both the Treasury and IRS must follow the law as written. If confirmed, I will instruct all my staff to do just that.

United States Committee on Finance, Hearing to Consider the Nominations of Jonathan Greenstein, to be a Deputy Under Secretary of the Treasury, and Donald Korb, to be Chief

Counsel of the Internal Revenue Service and an Assistant General Counsel in the Department of the Treasury (Sept. 10, 2025).

The IRS may be facing some political pressure regarding its "aggressive and novel positions" regarding GRATs, and the Trump administration, with urging from Republican Senators, may direct a change in the IRS's position regarding some of its positions about GRATs. It is interesting that GRATs have come to the attention of Senators, who are of the view that the IRS is taking aggressive and novel positions to impose their own views on what the law should be and that the new IRS Chief Counsel should review "from a fresh perspective those pending matters where the IRS is challenging the use of GRATs."

(5) **Common Situations Involving GRAT Substitutions for Grantor Notes.** Substitution transactions to acquire GRAT assets in return for a promissory note from the grantor are used routinely in various situations including (1) to obtain cash from the GRAT for the grantor to make estimated income tax payments, (2) to insulate a successful GRAT from later losses, or (3) to reacquire depreciated assets from a "losing" GRAT to re-GRAT them and hope the assets will appreciate from their depreciated values. In *Elca*n, it appears that all three reasons may have been applicable.

(6) **Planning Alternative – Pay Grantor's Note Before Annuity Payment Date.** A possible alternative to avoid the IRS's argument is for the grantor to transfer assets to the GRAT before the annuity payment date to pay off the note, and the GRAT could distribute those assets back to the grantor on the annuity payment date. Another approach is for the grantor to borrow funds from a bank to pay off the note shortly before the annuity payment is due; the cash could be used to make the upcoming annuity payment and the grantor could use the cash to pay back the bank loan.

(7) **What Interest Rate Should be Used in GRAT Substitutions?** What interest rate should be used in substitution transactions with GRATs? The notes must represent "equivalent value" for the assets acquired from the GRAT. In *Elcan*, the parties used a commercial rate. Arguably, an interest rate equal to the AFR could be used because for gift tax purposes, a transfer in return for an AFR note is not a gift under §7872. Using too high an interest rate could be abusive (it would shift additional value to the GRAT), and the IRS could argue that it would result in an additional contribution to the GRAT, which is prohibited under the regulations. In the event the values transferred to the GRAT in the substitution transaction are determined to be excessive, the taxpayer could take the position (or the trust agreement might explicitly provide) that the excess value is held by the trustee as a constructive trustee for the benefit of the person who made the excess value transfer. (The taxpayers made that argument in *Elcan* in case the IRS should determine that the notes used an excessive interest rate.)

(8) **Future Planning.** Should taxpayers use substitution transactions with GRATs in return for notes from the grantor in the future? The position being taken by the IRS is not supported by the regulations. Some reputable firms are still advising grantors that substitution transactions in return for grantor notes do not violate the regulations but are advising them of the surprising position being taken by the IRS.

38. Divorce Proceeding, Irrevocable Trust Created by Spouses Treated as Marital Assets Considered in Divorce Division, *C.S. v. R.H.*, 2025 N.Y. Slip Op. 51426(U) (Sept. 8, 2025).

a. **Brief Summary.** In *C.S. v. R.H.*, the New York Supreme Court faced a novel and high-stakes question: whether assets placed in irrevocable trusts—created during marriage for estate-tax planning and funded entirely with marital wealth—should be treated as marital property in a divorce.

C.S. ("Wife") and R.H. ("Husband") were married for twenty-four years and enjoyed extraordinary wealth following the $6.5 billion sale of the investment firm where Husband worked, Spear Leeds & Kellogg, to Goldman Sachs. Their net worth exceeded $120 million, leading to the creation of two irrevocable trusts in 2001—the R.H. 2001 Family Trust and the R.H. 2001 GST Trust (collectively, the

"Trusts")—intended to protect and transfer wealth for their descendants while minimizing estate taxes. The GST Trust was initially funded with $1.275 million and Husband sold 99% of an LLC with $20 million of assets to the trust for a $11.63 million promissory note (reflecting a 41.5% discount because of transfer restrictions). Husband forgave portions of the note at various times. GRATs were also formed in 2001 that transferred an additional $10 million to the Trusts.

Although the trusts were formally irrevocable, the court found that Husband retained near-total control over trust assets: he could remove trustees, manage investments, and used the trust-owned homes and funds to sustain the family's lavish lifestyle. "The family living expenses and lifestyle have been paid by the Trusts since 2002, when Husband retired and stopped taking a salary." When Wife filed for divorce in 2018, Husband unilaterally removed her from all fiduciary roles, evicted her from trust-owned residences, and decanted the trusts into new Delaware structures that granted him even broader authority.

The court held that these assets—though held in trusts—were effectively part of the marital estate because Husband had never relinquished control and both parties benefited from them throughout the marriage. Consequently, the court included the full $111 million value of the trust assets in the marital estate. None of the trust assets were awarded to Wife, but the value of the trust assets was considered in dividing the marital assets, resulting in an award of all non-trust marital assets to Wife and an additional $35.8 million "distributive payment" from Husband to Wife, as well as the payment of child support.

By the time of the court's opinion, the assets of the Trusts were worth $111.2 million and the non-trust assets were worth $70.2 million, for a total value of marital assets of $181.5 million. Wife received 50% of the total $181 million marital estate, comprising transfers of non-trust assets, a $35.8 million distributive payment (to be made in equal payments over ten years), and $1.68 million in attorney's fees. She also obtained child support of $8,333 per month (retroactive for a period of 87 months, or $724,971) though no ongoing maintenance was awarded due to the size of her settlement.

The decision underscores that when a grantor retains economic benefit or control over the assets of trusts created by the grantor, those assets may be treated as marital property in divorce. Even though the trust assets may not be awarded to a spouse, they may be considered as marital property in determining a "just and proper" division of non-trust marital assets. *C.S. v. R.H.*, 2025 N.Y. Slip Op. 51426(U) (Sept. 8, 2025) (Judge Kathleen Waterman-Marshall).

b. **Basic Facts.**

(1) **Parties.** C.S. (Wife) and R.H. (Husband) married in 1994. At the time of the marriage, Husband was an equity partner at a financial investment firm (SL&K), earning about $2 million annually, and Wife was a financial reporter, earning approximately $52,000 per year.

(2) **Wealth Explosion.** In 2000, Goldman Sachs acquired SL&K for $6.5 billion, giving the couple an instant net worth exceeding $120 million in cash and stock—acknowledged as marital property. The couple's lifestyle expanded dramatically, including multiple luxury homes, international residences, private travel, art, and real estate investments exceeding $22 million.

(3) **Funding of Irrevocable Trusts.** Two irrevocable trusts were created in March 2001: (1) R.H. 2001 Family Trust – for the benefit of their four daughters (distributions at age 30); and (2) R.H. 2001 GST Trust (Generation-Skipping Trust) – for future grandchildren, excluding daughters. Husband and Wife were not beneficiaries of either trust. Husband was Grantor, with power to remove and replace trustees and to substitute assets, making the trusts grantor trusts for income tax purposes. The GST Trust was initially funded with $1.275 million and Husband sold 99% of an LLC with $20 million of assets to the trust for a $11.63 million promissory note (reflecting a 41.5% discount because of transfer restrictions). Husband forgave portions of the note at various times. GRATs were also formed in 2001 that transferred an additional $10 million to the Trusts.

(4) **Administration of Irrevocable Trusts.** Husband controlled trust-related LLCs, serving as Investment Advisor with broad powers over asset management. Family homes (Shorewood Court in the Hamptons, Upstate Home, and others) were titled to LLCs owned by the trusts; the family lived there "rent-free for many years" and under below-market rents in later years. The family's living expenses—homes, staff, insurance, travel—were paid from trust assets.

(5) **Wife's Role and Knowledge.** Wife had no independent legal counsel during trust or LLC formation. She signed documents without review, trusting Husband's assurance that these were "tax shelters" and would not affect her interest. Her name was initially used as Trustee, later replaced by her sister, then removed entirely.

(6) **Husband's Control.** Husband retained complete operational control. He (1) could remove trustees and LLC managers at will; (2) personally set rents far below market value (e.g., $12,000/month for $54,000 market rent homes); and (3) directed real estate and investment transactions without oversight. Despite claiming "retirement," Husband worked full-time as Investment Advisor for entities managing $5.5 billion in trades.

(7) **Divorce and Post-Commencement Conduct.** Wife filed for divorce in May 2018. After filing, Husband: (1) removed Wife from all trust and LLC positions; (2) evicted her from homes held by the trusts; (3) decanted the Family Trust into the GST Trust (2019) and then into two new Delaware trusts (2023)—without court approval or Wife's consent; and (4) retained expanded powers as Investment Advisor under the Delaware structure, including removal of trustees and full discretion over investments. The court found that Husband's actions were intended to cut Wife out of the family wealth and consolidate control.

(8) **Assets and Valuation.** The total marital estate was approximately $181,469,321, including: (1) trust-held assets of $111,225,848 (including M.B. Holdings, real estate, and business interests); and (2) non-trust assets of $70,243,473 (including Manhattan apartments, investment accounts, art, and a $4.15 million Idaho home).

c. **Summary of Legal Analysis.**

(1) **Central Legal Issue.** The core issue was whether the court, in a divorce proceeding, could consider the value of assets placed in irrevocable trusts—funded with marital property and controlled by one spouse—as part of the marital estate for equitable distribution, without dissolving or making distributions from those trusts. (The court noted that trust assets can be distributed to a spouse "where the trust is a 'sham' and intended to defraud the other spouse or smuggle assets out of the marital estate," but concluded that did not apply to the Trusts.) The case had no perfect precedent. While earlier New York cases often excluded irrevocable trusts from the marital estate, Judge Kathleen Waterman-Marshall synthesized existing doctrines and concluded that when the trust operates as an extension of marital finances, equity requires inclusion of its value in the marital estate.

(2) **Presumption of Marital Property.** Under New York Domestic Relations Law § 236(B)(1)(c), all property acquired during the marriage and before commencement of a divorce is presumed to be marital property, regardless of title or form. The court reaffirmed that this presumption is broad, recognizing marriage as an economic partnership. Here, all trust assets originated from marital funds—the Goldman Sachs sale proceeds—so they fell squarely within the presumption.

(3) **Controlling Authority and Distinctions.** The court distinguished precedents that had not considered irrevocable trust assets in dividing marital estates in divorce proceedings. *Oppenheim v. Oppenheim* (2019) (excluded a trust created to benefit children because the spouses had relinquished control); *Perdios v. Perdios* (2016) (trust held one building; spouses had minimal control); *Hofmann v. Hofmann* (2017) (neither spouse retained power over trust property); *Markowitz v. Markowitz* (2017) (neither spouse retained power over trust property). By contrast, the facts here showed that Husband never relinquished control, serving as grantor, investment advisor, and de facto trustee. The trusts were created for estate tax sheltering but used to fund

the family's lifestyle. The court characterized them as marital vehicles, not independent third-party trusts.

(4) **Husband's Retained Control and Economic Benefit.** The court found that Husband (1) exercised unilateral authority to appoint and remove trustees and LLC managers, (2) personally directed all investment and real estate transactions, (3) used trust assets for personal and family living expenses, using the family real estate "rent free for many years" and under below-market leases in later years, and (4) was paid no salary but continued to manage trust-owned businesses. The court described Husband as the de facto trustee and held that "he never relinquished control, not even for a moment." The trusts were "embedded in the family's lifestyle."

(5) **Equitable Principles.** The decision relied on two guiding principles: (1) marital property is sacrosanct, and the court must protect each spouse's equitable interest; and (2) equity treats as done that which ought to be done (Cardozo's maxim), empowering the court to treat trust assets as if they remained marital. Because Wife's contributions—raising four children, managing homes, using her gift exemption amount, and sacrificing her career—enabled Husband to build and manage the trusts, her equitable claim to treat their value as marital property was recognized even without formal ownership.

(6) **Outcome and Legal Holding.** The court included the full value of trust assets ($111 million) in the marital estate for equitable distribution but did not dissolve the trusts or award trust assets to Wife. Instead, the court (1) awarded Wife 50% of the entire $181 million estate (valued with trust and non-trust assets combined), (2) ordered transfers of real estate and investment accounts totaling $79.9 million and a $35.8 million distributive payment (to be made in equal payments over ten years), (3) awarded $1.68 million in attorney's fees to Wife, and (4) awarded Wife child support of $8,333 per month (retroactive for a period of 87 months, or $724,971). No ongoing maintenance (alimony) was awarded because the distributive award was sufficient for Wife's future support.

How will Husband make the annual $3.58 million "distributive payments" since Wife received all the non-trust marital assets? "[I]f needed, Husband can borrow against trust assets to provide funds for himself under his expanded powers of the Property Trust. He can pay back any loan from income he earns as Investment Advisor and partner in ETC [an investment firm owned in part by the Trust for descendants and in part by Husband's revocable trust].")

d. **Planning Considerations.**

(1) **Case of First Impression Under New York Law.** The court framed the legal issue in the case as whether the value of marital assets in irrevocable trusts could be considered in fashioning an equitable distribution award without distributing such assets or dissolving the trusts. It acknowledged that "there is no case directly on all fours with this case," but concluded that "a synthesis of the controlling principles compels the Court to answer the question in the affirmative."

(2) **Retained Control and Economic Benefit Raises Risk of Considering Trust Assets as Marital Assets in Property Division on Divorce.** The court's central finding was that Husband never truly relinquished control over the trust assets. He (1) retained powers to remove and replace trustees and LLC managers at will, (2) acted as Investment Advisor with unrestricted discretion over all trust investments, (3) used trust property (homes, offices, cars, travel) for personal and family use, "rent-free for many years" or at below-market rents, and (4) directed income and expenses from the trusts as though they were his own funds. The court observed that "undisputed proof at trial established that the family expenses were (and continue to be) funded by the marital assets in the Trusts, either directly or indirectly by way of loans taken by Husband, which were approved by the Trustee, his close friend T.S." Because of this, the court concluded that the trusts were marital in substance, even if irrevocable in form. The family's lifestyle was "embedded in the trusts," and the husband's use of trust assets was continuous and personal.

When a grantor retains substantial economic benefits (residing in trust property, enjoying income, or controlling decisions), a divorce court may treat the trust as an extension of marital assets. The more the trust functions as a family piggy bank, the greater the likelihood its value will be included in equitable distribution.

(3) **Drafting and Structuring Implications.** Drafting observations arising from *C.S. v. R.H.* to maximize the protection of trust assets in a divorce proceeding between the grantor and his or her spouse include (1) use independent trustees, not family members or personal friends or business associates under the grantor's influence (the court referred to the trustee as "nothing more than a straw-man who rubber stamped each of Husband's decisions"), (2) do not give the grantor trustee removal powers, and (3) do not give the grantor investment powers (as an "investment advisor" or manager of an LLC owned by the trust) with the ability to control trust investments.

(4) **Respect Formalities.** Trust formalities should be respected. Only make distributions to the grantor or grantor's spouse pursuant to standards listed in the trust agreement. If the grantor and grantor's spouse are not listed in the trust agreement as beneficiary, do not provide any economic benefits to them unless structured as reasonable compensation for services rendered to the trust or as bona fide loans with a reasonable expectation of repayment to the trust.

Follow corporate formalities. The court noted several times that the record was "devoid of any meeting minutes or other corporate documents" showing Wife's involvement in any aspect of running the LLCs when she was the managing director of the LLCs.

(5) **Don't Inflame the Divorce Court Judge.** The divorce court judge appeared to be inflamed by actions the Husband took during the pendency of the divorce proceedings, sometimes in direct violation of court orders.

> Post-commencement, Husband unequivocally, unreservedly and unilaterally cut Wife out of the Trusts, removed her as Managing Director of the LLCs, terminated her access to trust accounts, kicked her out of her homes with all of their attendant luxury accommodations, and cut her off from the family lifestyle. His transfer of the parties' remaining interest in M.B. to the GST, decanting of the Family Trust into the GST and then the GST into the Property and Investment Trusts, unauthorized distributions of marital assets to the tune of $21,800,000, assumption of total control over the Foundation, and purchase of the Sun Valley Home and 2022 Boat with marital assets, violated the Automatic Orders as well as specific orders of the court which denied his request to do so. As Husband failed to fully respond to Wife's trial subpoena, the record may not contain a complete and accurate picture of the marital assets, both within and without the Trusts. These violations and bad-faith post-commencement conduct amount to egregious economic fault and support the finding that the *value* of the marital estate shall be distributed 50% to Wife under the "statutory catchall 'just and proper' factor" of DRL § 236B(5)(d)(16) …
>
> …
>
> … Husband engaged in emotional abuse after Wife filed for divorce. He evicted her from the family homes that she helped build and in which the children still reside; eliminated her name from Shorewood Court; cavalierly bulldozed her vegetable garden; angrily shouted at her to "get out" of the homes; disposed of her property and left a picture of his new girlfriend in its place — conduct which utterly disregarded not only her humanity but the years they spent together as a family. Husband's behavior was unwarranted and hateful.

Furthermore, Husband's testimony and his "edge of arrogance" at trial further influenced the judge.

> Husband presented as intelligent, accomplished, and confident, with an edge of arrogance and without any of the humility demonstrated by Wife. When questioned by Wife's attorney, Husband appeared frustrated, angry and defensive; he gave the impression that he need not account to anyone for any of his conduct as it relates to his wealth, his financial decisions, and his family. …
>
> Husband lacked credibility on the core financial issues, specifically as to the critical matter of his control over the Trusts.

(6) **Representation of Spouses by Independent Counsel?** If marital assets are to be transferred to an irrevocable trust for descendants, consider having the spouses represented by independent

counsel. Representation of spouses by independent counsel when trusts are created for descendants is not frequently done, but if a divorce dispute arises, the lack of independent counsel for a spouse could become an issue. The *C.S. v. R.H.* court observed:

> [Husband] told [Wife] that [his attorney] was helping and advising him on the Trusts, but she did not see the Trust or LLC documents until she was asked to sign them. For instance, Wife first heard of M.B. [an LLC owned by the Trusts] in the spring of 2004 when Husband asked her opinion about the name …. When the family was in New York that summer, she and Husband went to [the attorney's] office to sign some more estate planning documents; she was assured that her interests in the marital assets were protected, but was not provided with the documents before she was asked to sign them and she did not have independent legal counsel prior to or at the transaction.

(7) **Good Planning Gone Awry.** The drafting and structure of the Trusts and the estate planning in this case appears to have been well planned with sales to grantor trusts, GRATs (used to transfer $10 million to the Trusts), various LLCs owned by the Trusts, etc. Enormous values have accumulated in Trusts for the descendants. This case is a good example that estate planning transactions that are properly drafted, planned, and structured can go awry in the way that the plan is administered over the years. (The court noted several times that Husband did not follow the advice of his attorney regarding various issues.)

(8) **Section 2036 Estate Tax Inclusion Risk.** Husband's conduct of living in trust-owned homes, directing trust investments, paying family expenses from the trusts, and setting rents far below market value reflects retained enjoyment of the transferred assets. Even though the trusts were nominally irrevocable, Husband's control and personal benefit may risk gross estate inclusion under §2036.

(9) **Spell-Check.** The court's clerk might be well advised to use a spell-check program before submitting an opinion. The opinion misspelled "marital" as "martial" not once, not twice, but *thirteen* times. (Estate planners have become well accustomed to this very frequent misapplied auto correction in Word documents and have learned to search for the word "martial" before finalizing estate planning discussions and documents.)

(10) **Resources.** For a more detailed discussion of the treatment of trusts in divorce proceedings of a trust beneficiary or trust grantor, see Items 1-8 of ACTEC 2020 Fall Meeting Musings (Mar. 9, 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. Among other things, it includes a discussion of *Pfannenstiehl v. Pfannenstiehl*, 55 N.E.3d 933 (Mass. 2016), in which the Massachusetts Supreme Judicial Court refused to treat the divorcing husband's discretionary trust income and remainder interest in a trust created by the divorcing husband's father as part of the marital estate under the facts of the case, but stated that the "trust may be considered an expectancy of future 'acquisition of capital assets and income' in determining how to divide the assets that are subject to division" and may be considered in setting alimony payable to the divorcing wife.

39. Income Tax Effects of Early Termination of Trust, PLR 202509010 (Released Feb. 28, 2025)

a. **Facts and Rulings Requested.** Letter Ruling 202509010 involves a trust distributing an annual annuity to Grandchild for life, and following Grandchild's death, the annuity would be paid to Grandchild's issue, per stripes. The trust would terminate on the last to die of ten individuals, including Grandchild, at which time the trust would be distributed to Grandchild's issue, per stirpes. The parties proposed terminating the trust and paying to Grandchild and the Successor Remaindermen the actuarial value of their respective interests. The parties proposed that the trust be terminated and distributed in accordance with each beneficiary's actuarial value of each beneficiary's interest in the trust. The trustee could make non-pro rata distributions to satisfy the amounts passing to each beneficiary. The court approved the parties' proposed agreement, contingent upon receiving a favorable private letter ruling from the IRS.

The parties sought three rulings: (1) the termination will not cause the trust to lose is GST grandfather status, (2) no gifts will result, and (3) the termination "will cause Grandchild and the

Successor Remaindermen to recognize long-term capital gain" and will cause the Current Remaindermen to recognize capital gain or loss on property exchanged "for Grandchild's and Successor Remaindermen's interests in Trust," and "the amount realized by the Current Remaindermen will be equal to the fair market value of the property transferred to Grandchild and the Successor Remaindermen as the Proposed Distribution."

The ruling granted all three rulings requested. The first two were standard rulings. The third ruling addresses the income tax effects of early trust terminations.

PLR 202509010 is similar to Letter Rulings 201932001-201932010. Differences are that in the 2019 rulings, the current beneficiary held a mandatory income interest rather than an annuity interest, and the trusts were scheduled to terminate at the current beneficiary's death rather than continuing for current beneficiaries.

b. **Devastating Income Tax Effect.** The current beneficiary has a zero basis in his or her interest under the uniform basis rules, §1001(e)(1), so the full fair value that passes to Grandchild is long-term capital gain. (Grandchild had held his or her interest in the trust for more than one year.) The amount realized by the Successor Remaindermen is the fair market value of property transferred "to Grandchild and to the Successor Remaindermen." The ruling doesn't explicitly say so, but apparently the *gain* realized by the Successor Remaindermen upon the early termination is the amount realized (i.e., the total amount received) less their respective share of the uniform basis.

   The parties could be recognizing gain equal to a substantial percentage of the entire trust value! This depends on the amount of unrealized appreciation in the trust assets and the relative value of the current beneficiary's interest (because everything the current income beneficiary receives is gain with *no* basis reduction).

c. **Authorities.** PLR 202509010 cited Rev. Rul. 72-243 and *McAllister v. Commissioner*, 157 F.2d 235 (2d Cir. 1946), *cert. denied*, 330 U.S. 826 (1947) as authority for its position. The reasoning is that the term beneficiary received a distribution in exchange for transferring the term interest to the remainder beneficiaries. That reasoning may be subject to question since the beneficiaries merely received the actuarial value of their respective interests and no value shifted among them. Conceivably, the IRS might argue that the beneficiaries received "materially different" interests within the meaning of *Cottage Savings Association v. Commissioner*, 499 U.S. 554 (1991), but the PLR does not cite *Cottage Savings* and does not mention "material differences." (The gift tax portion of the ruling stated that "the beneficial interests, rights, and expectancies of the beneficiaries will be substantially the same, both before and after the termination.")

d. **Resources.** For a much more detailed of the issues, see the summary of 2019 rulings at Item 16 of Estate Planning Current Developments and Hot Topics (December 2020) found here and available at www.bessemertrust.com/for-professional-partners/advisor-insights. For an outstanding analysis of the 2019 rulings and of the IRS's views about trust commutations, see Edwin Morrow, *Trust Modifications and Trust Terminations: Unintended Tax Consequences and How to Avoid Them*, SOUTHERN FEDERAL TAX INST. (Oct. 2025); Ladson Boyle, Howard Zaritsky & Ryan Wallace, *The Uniform Basis Rules and Terminating Interests in Trusts Early*, REAL PROP., TR. & EST. L.J. 1 (Spring 2020) (hereinafter "Boyle, Zaritsky & Wallace, Uniform Basis Rules"); Ed Morrow, *Potential Income Tax Disasters for Early Trust Terminations*, LEIMBERG ESTATE PLANNING NEWSLETTERS #2753 (October 9, 2019) (hereinafter "Morrow, Early Trust Terminations"), Steven Gorin, *Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications*, ¶II.J.18 (2019) (available from author), and Douglas A. Kahn, *Gain from the Sale of an Income Interest in a Trust*, 30 VA. L. REV. 445 (2010).

40. Basis Adjustment at Grantor's Death for Grantor Trust Assets, *Belmont Investments, LLC v. Commissioner,* T.C. Docket No. 14039-25 (petition filed Oct. 3, 2025) (taking a position contrary to Rev. Rul 2023-2)

a. **Brief Synopsis of Case Facts and Issues.** Wife died December 14, 2018. Thereafter, each trust was longer a grantor trust as to the portion contributed by her, and one-half the assets in each trust were deemed transferred by her to a non-grantor trust. Each trust remained a grantor trust for Husband as to the one-half portion contributed by him.

The trust agreements authorized the trustee to allocate assets disproportionately between trusts so long as the total value of all property owned by each Grantor Trust was divided equally. The trustee allocated the 91.824% member interest disproportionately between the Husband's and Wife's portions of the trusts, allocating 65.014% to the non-grantor trusts (representing Wife's portion) and 26.810% to the continuing grantor trusts (representing Husband's portion).

On its 2018 partnership income tax return, Belmont made the §754 election as a result of Wife's death. This election would adjust the basis of partnership assets attributable to the non-grantor trusts (representing the Wife's portion) to reflect the adjustment in basis (if any) under §1014 of the non-grantor trusts' basis in its member interest. The 2018 return took the position that this optional basis adjustment of LLC assets was about $37.3 million.

The Grantor Trusts attributable to Wife's portion were not included in her gross estate for estate tax purposes, and Revenue Ruling 2023-2 takes the position that a basis adjustment is not available for assets in a grantor trust that are not included in the deceased grantor's gross estate. Accordingly, Belmont attached a Form 8275, Disclosure Statement, to its 2018 Form 1065 stating:

> THE PARTNERSHIP MADE AN OPTIONAL BASIS ADJUSTMENT IN 2018 DUE TO THE DEATH OF A PARTNER. THE DECEASED PARTNER HELD THE PARTNERSHIP INTERST IN A GRANTOR TRUST FOR WHICH A BASIS ADJUSTMENT WAS MADE UNDER I.R.C. SECTION 1014. THE GRANTOR TRUST WAS AN IRREVOCABLE TRUST THAT WAS NOT INCLUDABLE IN THE ESTATE OF THE DECEDENT.

On December 20, 2018, Belmont sold land for about $12.8 million and adjusted the basis of such land by $4,623,309 (attributable to the non-grantor's trusts' pro rata portion of the land for its 65.014% interest). The basis adjustment also reduced gain reported on the installment method and increased a deprecation deduction on the 2019 Belmont income tax return as a result of the basis adjustment.

Husband exercised his substitution power on November 30, 2019, to acquire the 26.20767% member interest owned by the Seldin Grantor Trust (but not the 0.1003017% interests owned by the Grandchildren's Grantor Trusts that were treated as owned by the Husband because they were grantor trusts).

Husband died on January 13, 2020, and Belmont's 2020 partnership income tax return made the §754 election to adjust the basis of partnership assets by reason of Husband's death regarding (i) the 26.20767% interest that had been acquired by Husband and that was included in his gross estate, as well as (ii) the 0.1003017% interest that was owned by Husband's portion of the Grandchildren's Grantor Trusts (and that was not included in his gross estate). (The IRS does not dispute the basis adjustment attributable to the 26.20767% interest that was included in Husband's gross estate.) The Form 8275, Disclosure Statement was attached to the 2020 partnership income tax return.

The IRS position is that the trusts do not receive a basis adjustment at the death of each respective grantor as to assets in the trusts that are not included in the decedent's gross estate. Accordingly, no optional basis adjustment of assets inside the partnership would be made relating to the member interests in the Grantor Trusts at each spouse's death, resulting in tax underpayments of about $21 million in 2018-2020.

Belmont Investments, LLC v. Commissioner, T.C. Docket No. 14039-25 (petition filed Oct. 3, 2025).

b. **Income Tax Treatment of Joint Grantor Trusts.** The treatment of a grantor trust created jointly by spouses as a result of contributing community property to the trust is unclear. During the joint lives of the grantors, the trust is treated as grantor trusts as to the portions represented by each grantor's

contribution to the trust. Case law does not establish how the trust is treated for income tax purposes at the death of the first of the grantors. An alternative that is often used in practice is to divide that trust into separate equal trusts, one of which would be a non-grantor trust as to the deceased spouse's portion of the contribution and the other would continue as a grantor trust as to the surviving spouse's portion of the contribution. That seems to be the simplest approach administratively (for both the taxpayer and the IRS), but conceivably the trust could be treated as continuing as a single trust for income tax purposes, with one-half being reported as a non-grantor trust and one-half being reported as a grantor trust. (Some planners have referred to an analogy of cream in coffee; once mixed, the cream and coffee cannot be separated.)

If the trust is divided into separate trusts (one a non-grantor trust and the other a grantor trust as to the surviving spouse), another uncertainty is whether the assets can be divided in a non pro rata fashion in making that division. While a trust agreement may authorize a trust to allocate assets in a non pro rata manner if trusts are divided, whether that non pro rata division will be respected for federal income tax purposes is another issue. In *Belmont*, the trustee of the trusts allocated about two-thirds of the member interest in Belmont that was owned by the Grantor Trusts to the Wife's portion (which became non-grantor trusts) to increase the basis adjustment in the LLC assets if a basis adjustment is allowed under §1014 at the grantor death as to assets in the trust (even though they are not included in the grantor's gross estate).

c. **Section 1014 Background and Rev. Rul 2023-2.**

(1) **Section 1014 Statutory Provisions.** Section 1014(a) provides generally that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent is adjusted to the fair market value at the date of death. Section 1014(b) describes seven categories of assets that "shall be considered to have been acquired from or passed from the decedent. (An eighth category applies for decedents dying before 2005.)

(2) **Arguments.** Some planners maintain that assets in a grantor trust should receive a basis step-up at the grantor's death because until that time the assets were deemed owned by the grantor for income tax purposes (*See* Rev. Rul. 85-13, 1985-1 C.B. 184), and after the grantor's death they are "acquired from a decedent" by someone else. *See e.g.*, Gans & Blattmachr, *Grantor Trust Assets and Section 1014: New Ruling Doesn't Solve the Problem*, J. TAX'N (Sept. 2023); Blattmachr, Gans & Jacobson, *Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death*, 97 J. TAX'N 149 (Sept. 2002); Treas. Reg. §1.1001-2(c)Ex. 5 (grantor of grantor trust was considered the owner of all trust property in a grantor trust and when grantor renounced powers that caused trust to be a grantor trust, partnership interest owned by the trust was considered to have been transferred from grantor to trust for Federal income tax purposes). Many other planners are uncomfortable with that position. *See* Austin Bramwell & Stephanie Vera, *Basis of Grantor Trust Assets at Death: What Treasury Should Do,* 160 TAX NOTES FEDERAL 793 (Aug. 6, 2018) (suggesting that §1015(b) could provide a rationale for not adjusting basis of grantor trust assets at the grantor's death).

(3) **Political Pressure.** This item in the 2022-2023 Plan is apparently the IRS's response to a statement by Secretary of the Treasury Janet Yellen's in a dialogue with Representative Bill Pascrell (D-New Jersey) at a June 8, 2022, House Ways and Means Committee hearing that the IRS would be implementing guidance on the "infamous stepped-up basis loophole … Very soon. Very soon." The IRS responded by adding the issue to the Priority Guidance Plan (released November 4, 2022) and on March 29, 2023, by releasing Rev. Rul. 2023-2.

(4) **Revenue Ruling 2023-2.** Rev. Rul. 2023-2, IRB 2023-16 (issued on March 29, 2023, and dated April 17, 2023) denies a basis adjustment under §1014(a) for assets gifted to an irrevocable grantor trust by completed gift that are not included in the deceased grantor's gross estate. This result was anticipated. The Ruling reasons in a very straightforward manner that such assets are not in any of the categories in §1014(b) that "shall be considered" to have been acquired from or passed from the decedent and therefore do not receive a basis adjustment under §1014(a). The ruling posits that assets in a grantor trust attributable to gifts that are not in the deceased grantor's gross estate are not properly acquired by bequest, devise, or inheritance under

§1014(b)(1). Section 1014(b)(2), (3), or (4) do not apply where the grantor does not have the power to revoke or amend the trust or appoint the assets of the trust. Section 1014(b)(6) refers to community property, and §1014(b)(9) and (10) refer to assets included in the decedent's gross estate. "Because at [the grantor's] death [the trust asset] does not fall within any of the seven types of property listed in § 1014(b), [it] does not receive a basis adjustment under § 1014(a)."

The facts on which the Ruling is based, as stated at the beginning of the Ruling, have several important caveats: (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.

The complete holding of the Ruling is:

> A creates T, an irrevocable trust, retaining a power which causes A to be the owner of the entire trust for income tax purposes under chapter 1 but does not cause the trust assets to be included in A's gross estate for purposes of chapter 11. If A funds T with Asset in a transaction that is a completed gift for gift tax purposes, the basis of Asset is not adjusted to its fair market value on the date of A's death under § 1014 because Asset was not acquired or passed from a decedent as defined in § 1014(b). Accordingly, under this revenue ruling's facts, the basis of Asset immediately after A's death is the same as the basis of Asset immediately prior to A's death.

The Ruling also confirms in a footnote that it does not alter the result of Rev. Rul. 84-139, which held that property from a non-resident non-citizen decedent that is not included in his or her gross estate may receive a basis adjustment if the property is acquired by bequest, devise, or inheritance as described in §1014(b)(1) "or is otherwise specifically described in § 1014(b)."

(5) **Ruling Does Not Address Argument Regarding Change of Deemed Ownership For Income Tax Purposes at Death of Grantor.** Interestingly, the Ruling does not directly discuss whether assets in the grantor trust are "property passed from a decedent" in light of the fact the grantor is viewed generally as the deemed owner of the trust assets until the grantor's death for income tax purposes (Rev. Rul. 85-13). That issue was mentioned, albeit briefly, however, in IRS Guidewire Issue Number RR-2023-02 (March 29, 2023) that described Rev. Rul. 2023-2. It states the result reached in the Ruling "even though the grantor trust's owner is liable for Federal income tax on the trust's income." Instead, the Ruling merely views the list of circumstances in §1014(b) as the only ways property can pass from a decedent. That might seem contrary to regulations that treat a grantor as having "transferred ownership" of assets from the grantor to the trust when a grantor trust ceases to be a grantor trust, Reg. §1.1001-2 (c) Ex.5, and a "transfer" from a grantor might seem analogous to "passing" from a decedent. *See* Mitchell Gans & Jonathan Blattmachr, *Grantor Trust Assets and Section 1014: New Ruling Doesn't Solve the Problem*, J. TAX'N (Sept. 2023).

(6) **Treatment of §1014(b) Categories as Exclusive Ways to be "Acquired From" or "Passed From" the Decedent.** Rev. Rul. 2023-2 says the **only way** an asset can be "acquired from a decedent" for purposes of getting a basis adjustment under section 1014(a) is to be in one of the categories listed in §1014(b), and none of the sub-sections in 1014(b) apply. From the Ruling: "For property to be acquired or passed from a decedent for purposes of § 1014(a), it **must** fall within one of the seven types of property listed in § 1014(b)." (emphasis added). The ruling does not cite any authority for the proposition that the seven types of situations listed in §1014(b) are the only ways property can be acquired from a decedent for purposes of §1014(a).

A possible alternate reading of section 1014(b) is that it is not an exclusive list, but the Code is effectively providing safe harbors—if you meet one of those situations, the property "shall be considered" to have been acquired from a decedent. Section 1014(b) does not explicitly say it is an exclusive list. It just says "the following property shall be considered to have been acquired… from the decedent"; it does not say "**only** the following property shall be considered …". If §1014(b) is read as a nonexclusive list of ways to acquire property from a decedent, one could argue that property in a general sense passes from the decedent for income tax purposes when the property ceases to be owned by that person for income tax purposes by reason of the person's death.

In any event, the IRS has clearly stated its view (but without any kind of express discussion of why it is rejecting the possible view that §1014(b) is merely a non-exclusive list of ways property can be acquired from a decedent).

(7) **Penalties.** If a taxpayer wants to take the position that the IRS's position in Rev. Rul. 2023-2 is wrong, the recipient of the grantor trust asset might want to report capital gain upon the sale of the asset as if no basis adjustment applied, and then claim a refund, taking the position that a basis adjustment did apply at the death of the grantor of the grantor trust. That approach would avoid underpayment penalties if the taxpayer's position is not upheld.

If the refund approach is not used, must the taxpayer disclose the position on Form 8275 to avoid accuracy related and understatement penalties if the position of Rev. Rul. 2023-2 is upheld? Section 6694(a) provides that such penalties may apply if the preparer knew of the position and either (a) the position is related to a tax shelter or reportable transaction, (b) the position is not disclosed and there was not substantial authority for the position, or (c) the position is disclosed but there was not a reasonable basis for the position. Whether there is substantial authority for the view that a basis adjustment applies for assets in grantor trusts at the grantor's death is uncertain. Some commentators take the position that substantial authority exists and penalties would not apply even if the position is not reported on Form 8275. *See* Alan Gassman, Kenneth Crotty, Brandon Ketron, & Peter Farrell, *Revenue Ruling 2023-2 Got It Wrong? The Case for a Stepped-Up Basis When the Grantor Dies*, LEIMBERG INCOME TAX PLANNING NEWSLETTER #244 (April 3, 2023). The taxpayer could expect strong resistance from the IRS, though, in light of the priority it has placed on this issue and the clear position it has taken in Rev. Rul. 2023-2. In *Belmont*, the partnership income tax return making the §754 election included the Form 8275 disclosure statement.

(8) **Background Information.** For a more detailed discussion of this issue, see Item 6.c of Estate Planning Current Developments and Hot Topics (December 2019) found **here** and Item 5.b of Aucutt, *Washington Update: Pending and Potential Administrative and Legislative Changes* (June 2023) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.