LOOKING AHEAD – Estate Planning in 2026 & Current Developments
(Including Observations from Heckerling 2026)

May 2026

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Important Information Regarding This Summary

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Introduction

This LOOKING AHEAD summary addresses planning trends and important estate planning issues for 2026, including various current developments in 2025. It includes some observations from the 60th Annual Heckerling Institute on Estate Planning™ that was held January 12-16, 2026, in Orlando, Florida.

- Items 1-8 highlight planning issues that will be central to many estate planning clients in 2026.
- Items 9-13 highlight some important administrative pronouncements from the IRS and FinCEN.
- Items 14-24 include musings from some of the presentations at the 2026 Heckerling Institute. (Various other comments from the Heckerling Institute are sprinkled throughout the paper.)
- The subsequent items discuss various current developments, IRS rulings, and cases.
- The Appendix includes summaries of select tax provisions in and developmental history of the One Big Beautiful Bill Act (OBBBA).

Items 1-8 highlight planning issues that will be central to many estate planning clients in 2026.

1. Trending in 2026

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), 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.

c. **Income Tax Planning; Basis Adjustment Planning.** 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. A very small sliver of the population is subject to estate tax, but the estates of all decedents receive a basis adjustment.

d. **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. So, modifications of such trusts may be appropriate. See 1.f below.

e. **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 include the other spouse as a discretionary potential beneficiary, which could allow the marital couple to retain potential access to assets gifted to the trust,, see Item 17 below;
- 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 to utilize inflation adjustments to the $15 million exclusion;
- 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**.

f. **Decanting and Trust Modification; Gift Consequences; Governing Law Issues.** Modification of trusts by decanting, nonjudicial modification, or judicial modification continue to be a growing trend to accommodate changing circumstances. Recent IRS guidance and cases reflect a growing attention to possible gifts by beneficiaries by consenting or failing to object to trust modifications or trust decantings. See Items 19, 28.e, 28.g,28.h and 28.h(1) below.

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. **Greenbooks.** Tax legislative proposals from the Biden Administration in the FY 2025, 2024, and 2023 Greenbooks included detailed extensive legislative tax proposals (with broad sweeping changes for transfer taxes and grantor trusts), as summarized in Item 3.a. of LOOKING AHEAD-Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** The Trump administration budget proposals during President Trump's first term and during his second term have not included detailed legislative tax proposals. *See* President's Fiscal Year 2026 Discretionary Budget Request (May 2, 2025), **https://www.whitehouse.gov/wp-content/uploads/2025/05/Fiscal-Year-2026-Discretionary-Budget-Request.pdf**.

b. **IRS Funding.**

(1) **Reduction of Estate and Gift Tax Examiners.** Only about 80 estate and gift tax examiners in the IRS are currently serving (and a fair number of them are relatively new).

(2) **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. 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 (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).

The five-bill fiscal 2026 appropriations "minibus," signed by President Trump on Feb. 3, 2026, funds the Treasury and the IRS through September 2026. It includes the fiscal 2026 labor, health, and human services bill, which includes an additional rescission of $11.66 billion that was authorized in the Inflation Reduction Act, leaving just about $10 billion of the original $80 billion in the IRA funding, with about $7 billion specifically for operations support. The Congressional Budget Office estimates that the rescission of this funding will result in reduced revenues of $38.6 billion over the 2026-2035 period. Congressional Budget Office *Cost Estimate, H.R. 7148, Consolidated Appropriations Act, 2026* (Jan. 21, 2026), **https://www.cbo.gov/system/files/2026-01/hr7148-CAA-2026.pdf**.

(3) **IRS Appropriations for Fiscal Year 2026.** Among the five full-year funding bills in the minibus package is the fiscal 2026 financial services and general government bill, which reduces funding for the IRS to $11.2 billion, 9 percent less than the $12.3 billion IRS budget for fiscal year 2025. Enforcement funding would be reduced by about $439 million from FY 2025 (8% cut), and the operations support budget would be reduced by $941 million (a 23% cut). *See* Cady Stanton, *Trump Signs Funding Deal With IRS Cuts*, TAX NOTES TODAY FEDERAL 534 (Feb. 3, 2026).

(4) **Impact of IRS Funding Cuts on Revenue Collections.** Cuts in IRS enforcement funds will result in substantial revenue losses. As cited above, the Congressional Budget Office estimates that the rescission of $11.66 billion of IRS funds will result in $38.6 billion reduced revenues over ten years. A recent study by U.S. Department of Treasury staff concludes that for every dollar that the IRS spends auditing taxpayers above the 90th percentile of earners, it yields more than $12 in revenue, and audits for below-median income taxpayers yield $5 in revenue for every dollar spent. *See* William C. Boning, Nathaniel Hendren, Ben Spring-Keyser, & Ellen Stuart, *A Welfare Analysis of Tax Audits Across the Income Distribution*, 140 QUARTERLY J. OF ECONOMICS 63 (Feb. 2025).

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.*

The combination of the plan to eliminate the Tax Division in the Department of Justice (see Item 2.b(7) below), cuts to IRS funding, and allowing a government agency (ICE) to access taxpayer information, suggests 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.")

The IRS criminal divisions opened 34 investigations into abusive tax schemes in fiscal year 2025, down from 92 the prior year and about a 40% drop or more from every year in the past decade. *See* Erin Schilling, *Criminal Tax Scheme Probes Plummet as Trump IRS Priorities Shift*, BLOOMBERG DAILY TAX REPORT (Dec. 17, 2025). Five Democratic senators on Jan. 28, 2026, sent a letter to Treasury Secretary Bessent and the Chief of the IRS Criminal Investigation requesting an explanation of the decrease in investigations, how staffing cuts contributed to the decline, what impact it will have on revenue, and how the IRS will enforce the law after these cuts. *See* Erin Schilling, *Senate Democrats Prod IRS on Drop in Tax Scheme Investigations*, BLOOMBERG DAILY TAX REPORT (Jan. 29, 2026).

(5) **IRS Enforcement Funding Is Controversial.** 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). At the signing ceremony when President Trump signed the minibus rescinding funds for the IRS from the Inflation Reduction Act and decreasing IRS appropriations for fiscal 2026, he "highlighted the bill's cuts to 'abusive and weaponized IRS programs.'" *See* Cady Stanton, *Trump Signs Funding Deal With IRS Cuts*, TAX NOTES TODAY FEDERAL 534 (Feb. 3, 2026).

(6) **Reduction of IRS Employee Workforce by 25 Percent.** Prior to 2025, the IRS took steps to utilize the additional funding for enforcement that it was able to access and added to its headcount for enforcement (including adding estate and gift tax examining officers), but the Trump administration has cut IRS staffing. There are some reports that the Trump administration at one point aimed to cut up to half of the IRS's roughly 100,000-person 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 fell 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 Administration's reduction in appropriated IRS funding next year.

(7) **Tax Division of Justice Department Dissolved.** The almost century-old tax division of the Justice Department was 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 Senate 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); 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)..

In the summer of 2025, House Speaker Mike Johnson (R-LA) expressed his goal to enact a second reconciliation act "in the late fall" of 2025, but that did not happen.

Senate Finance Committee Chair Senator Lindsay Graham (R-SC) has indicated that after coordinating with President Trump and Majority Leader Thune, he will proceed with plans for a reconciliation act in 2026. Possible topics include funding of the Department of Homeland Security, some elements of the Safeguard American Voter Eligibility (SAVE) American Act, and supplemental defense funding for the Iran war. Tax provisions do not seem to be a priority. Query whether some isolated technical corrections to OBBBA might be included?

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 (for FY 2026-2027) 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).

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, and adjusting payments upward under the Medicare fee schedule, and possible reconciliation act topics could include the Affordable Care Act enhanced credits). 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, 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, 2025).

e. **Ending Capital Gains on Primary Home Sales; Withdrawals from 401(k) Accounts for Home Down Payments.** The No Tax on Home Sales Act (H.R. 1340), introduced in February 2025, by House Ways and Means Committee member Jimmy Panetta (D-CA), would raise the exclusion to $500,000 ($1,000,000 for joint returns), indexed for inflation. Senate Finance Committee member John Cornyn (R-TX) introduced an identical bill (S. 3332). (Similar bills have been introduced previously.) The measure has been criticized as 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.

Senators Ted Cruz (R-TX) and Tim Scott (R-SC) have urged Treasury Secretary to provide additional tax relief on capital gains without going to Congress in hopes of boosting the housing supply. They maintain that the IRS has the authority to define cost basis to adjust the basis of stocks or real estate for inflation. Some estimates are that indexing gains for inflation could cost $100 to $200 billion over a decade. *See* Chris Cioffi, *Cruz, Scott Seek Capital Gains Tax Cut, Skirting Congress,* BLOOMBERG DAILY TAX REPORT (Mar. 3, 2026).

The Trump administration has considered proposing allowing withdrawals from 401(k) accounts for down payments on home purchases that would require a shift in long-held regulations on plan withdrawals and possibly new legislation. *See* Brett Samuels, *Trump's 401(k) Home Buyer Idea Requires Retirement Rule Shifts*, BLOOMBERG DAILY TAX REPORT (Jan. 16, 2026).

f. **Senator Van Hollen Proposal to Increase Estate Tax.** The Strengthen Social Security by Taxing Dynastic Wealth Act (S. 4196), proposed by Senator Van Hollen (D-MD), would add estate tax rate brackets of 41%, 43%, and 45%, decrease the estate tax basic exclusion amount to $3.5 million (not indexed), decrease the gift tax exclusion amount to $1.0 million (not indexed), and reduce the DSUE amount available for gifts by the surviving spouse to no more than $1.0 million. The changes would be effective for gifts made after and for decedents dying after 2026. Estate and gift tax revenue would be transferred.

3. Brief Musings About the "One Big Beautiful Bill Act" (OBBBA) (the Act)

a. **Bluebook from Joint Committee on Taxation.** The Joint Committee on Taxation typically issues a "General Explanation of Tax Legislation," commonly referred to as the "Bluebook," at the end of each two-year term of Congress. It sometimes also issues a separate Bluebook regarding significant tax legislation, such as it did for the Tax Cuts and Jobs Act. An OBBBA-dedicated Bluebook "is in process (including a preliminary version being submitted for proofing by the Government Printing Office) and there is hope it will be released soon." Miller & Chevalier, *Book of Dreams – Status Update on the Greenbook and the Blueb*ook (March 16, 2026).

b. **"Permanent" Tax Cuts.** The Act "permanently" (meaning, with no scheduled sunset of the cuts at some point) extends many of the tax cuts in the Tax Cuts and Jobs Act. Making substantial tax cuts "permanently" has not been done in prior reconciliation acts (passed with only a majority in the Senate) because of the Byrd Rule in the Senate. The permanent tax cut in the Act was accomplished by having the Senate adopt a "current policy" approach for determining the baseline against which the fiscal impact of the Act is measured. See Appendix, paragraph aa below.

c. **Estate and Gift Exclusion Amount.** The "permanent" extension of the estate and gift exclusion amount (and its increase to $15 million to be inflation adjusted), is very important, providing a level of stability to the federal transfer tax system that has been absent for decades. It is unlikely this will be changed in the foreseeable future; reducing the exclusion amount would require having a Democratic President and significant Democratic majorities in the House and Senate. The estate tax is a highly charged issue, and some Democratic Congresspersons would strongly oppose reducing the exclusion amount.

d. **Application of the 2/37ths Reduction Under §68 to Trusts and Estates.** Section 68 requires reducing itemized deductions by 2/37ths (about 5.4%) for taxpayers in the top marginal income tax bracket ($16,000 for trusts and estates). The statutory provisions of §68 and other relevant sections are rather convoluted, but they literally provide that trust and estate expenses unique to trusts and estates, distribution deductions, and charitable deductions for trusts and estates are all "itemized deductions," and therefore are subject to the 2/37ths reduction. This issue will arise for trusts and estates filing their 2026 income tax returns (typically sometime in 2027).

Applying §68 to distribution deductions is especially unfair. The distribution deduction for trusts and estates avoids double taxation; distributions up to the amount of distributable net income are subject

to taxation to the beneficiaries but are not taxed to the trust or estate, *because of* the distribution deduction. If §68 applies to distribution deductions, generally there will be double tax on 5.4% of the income of trusts and estates. The IRS conceivably could issue guidance (perhaps in Form 1041 instructions) providing that distribution deductions under §651 and §661 are viewed for §68 purposes not as deductions but as allocations, so the 5.4% reduction of itemized deductions under §68 would not apply to distribution deductions of trusts and estates.

For a detailed discussion of the application of §68 to trusts and estates, see Appendix, Paragraph I below.

e. **Qualified Small Business Stock (QSBS) Exclusion**. The exclusion of income under §1202 resulting from income from the sale of qualified small business stock (QSBS) is expanded under the Act in several significant ways. See Item 15 below.

f. **Trump Accounts; A Way To Fund Roth IRAs (Eventually) for Minors.** The Act permits contributions of up to $5,000 per year to "Trump accounts" for children under age 18. Special limitations apply regarding distributions, investments, etc. until January 1 of the year the minor turns age 18 (the "growth period"), at which time the account is subject to the rules for individual retirement accounts (IRAs). That is not overly attractive; as IRAs, withdrawals will ultimately be subject to ordinary income tax, and the parent might prefer to simply fund investment accounts in the name of the minor so that future growth would eventually be taxed as long-term capital gain. However, at age 18, when the accounts convert to IRAs, they can be converted to Roth IRAs. (Notice 2025-68 specifically says the rules regarding "Roth conversions" will apply.) As Roth IRAs, no minimum distributions would be required during the individual's lifetime, and when amounts are withdrawn they would be income-tax free. That is very attractive. *See* Ashlea Ebeling, *The Hack That Turns Trump Accounts Into Multimillion-Dollar Tax-Free Nest Eggs,* Wall St. J. (Mar. 23, 2026).

Roth IRAs generally can be funded for minors only to the extent they have earned income (up to a ceiling amount); otherwise, a parent cannot fund a Roth IRA for a minor. The $5,000 amounts contributed annually to a Trump Account could appreciate to significant amounts by age 18. They could then be converted to Roth IRAs (the parent might pay the income tax required to convert the Accounts to Roth IRAs). Tax-free growth in the IRA over the following 40-50 years could result in the individual having a very sizable investment account at retirement, which could be withdrawn after age 59½ free of income tax (or allowed to stay in the account over the individual's lifetime and continue to accumulate tax-free).

Contributions to Trump accounts are not treated as "present interest" gifts qualifying for the gift tax annual exclusion. Accordingly, donors to Trump accounts will be required to file gift tax returns reporting the gifts. The American Institute of CPAs has recommended to the IRS, in a letter dated Feb. 25, 2026, that it issue guidance providing that transfers to Trump Accounts be treated as present interest gifts.

g. **Charitable Income Tax Deductions.** Various changes are made for charitable deductions (60% limitation for cash gifts, 0.5% floor on charitable deductions for taxpayers who itemize deductions, and $1,700 credit for contributions to scholarship granting organizations beginning in 2027). Another important change for taxpayers who claim the standard deduction is a permanent above-the-line charitable deduction of $1,000 for individuals and $2,000 for married couples. This change could have a broad impact; the Tax Foundation estimates that nearly 86 percent of taxpayers will likely take the standard deduction in 2026.

Consider making a large contribution in one year to a donor advised fund that can fund desired annual charitable contributions for future years. If an individual does not have substantial deductions other than charitable deductions, "bunch" charitable contributions, perhaps to a donor advised fund (say, once every four years, perhaps partly to a donor advised fund that can dole out contributions to charities in the other three years), which would permit the individual to take advantage of the standard deduction and the $1,000/$2,000 above-the-line charitable deduction in those other three years. .

h. **529 Account Enhancements; Trust and UTMA 529 Accounts.** Section 529 savings plans have more favorable tax treatment than Trump accounts, and the Act makes significant helpful enhancements for 529 accounts (including increased permissible annual distributions for purposes beyond just tuition and distributions for credentialing expenses).

Some clients are asking about having a trust establish a 529 account for a beneficiary. A trust can create separate 529 plans for trust beneficiaries (meaning that the trust would avoid income taxation on the growth within the 529 account). The trust would be the owner and would have the authority to change the beneficiary once a particular trust beneficiary no longer needed educational expenses.

The Uniform Transfers to Minors Act will be revised in the summer of 2026 to allow the custodian of a UTMA account to fund a 529 account.

i. **Detailed Summary of Selected Provisions of the Act.** Summaries of selected tax provisions in the Act and behind-the-scenes background issues about the evolution of the Act are described in the Appendix, Summaries of Selected Tax Provisions in OBBBA and Background Issues.

4. 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. Active pursuit of estate tax repeal legislation does not appear on the horizon.

Some suggest that the continued existence of the estate tax has political advantages and that its existence provides "reputational shelter" for wealthy families. Bridget Crawford & Maggie Meinhardt, *The Estate Tax Lives On, but Only in Name*, 188 TAX NOTES FEDERAL 921 (Aug. 11, 2025).

5. 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 in light of governmental policy priorities. (Appraisers report that they were very 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.** Non-grantor trusts may become more important for various tax purposes other than estate tax savings. See Item 6 below.

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. See Item 7 below.

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.

6. Planning With 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). Contributing to and accumulating assets in non-grantor trusts may have various income tax advantages, 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. The §674, §675, and §677 provisions must be navigated very carefully.

For a detailed discussion of the various income tax advantages of using non-grantor trusts and the details of structuring trusts as non-grantor trusts, see Item 8 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

7. 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 increased exclusion amount 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 over 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 powerholder, 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 approaches 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 (see Item 25.a below). 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 from 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 to 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 with respect to the underlying assets, the partners could initially transfer their partnership interests to a 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 might use 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 in *Riese* 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. Section 2038 may cause inclusion in the gross estate if the settlor's creditors can reach the trust assets at the donor's death. *See Outwin v. Commissioner*, 76 T.C. 153 (1981).

(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, which possibly could be exercisable only with the consent of a non-adverse party (but not the grantor) or exercisable only after being requested by a designated family member to consider granting the power; consider using broad exculpatory language for the person authorized to grant the power of appointment; consider providing that the powerholder has no duty to monitor whether a general power should be granted; but query whether the mere authority of a third party to grant a general power of appointment to a beneficiary has the effect of causing the beneficiary to be treated as holding a general power of appointment exercisable with the consent of a non-adverse party, which would result in the beneficiary being deemed to have 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. Each of these alternatives is 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 regardless of which 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." For 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 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 orsell 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 over the trust. At the parent's death, the inclusion of the assets in his or her estate may generate no estate tax, 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 trust 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 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 a 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. Reg. §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 one 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 with respect 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 client 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 powerholder's estate unless the contingency is resolved at or prior to the powerholder'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.

"Beneficiary Deemed Owner Trust" (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.

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).

8. 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 increased 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.

Transfer planning can still be important, however, even for more modest estates, in states that have fairly low exemption amounts. Also, non-U.S. persons remain subject to federal estate tax. The federal exclusion amount for NRAs 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 GST tax at the death of the beneficiary unless GST exemption has been allocated to the trust or 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 considered.

b. **Review Formula Clauses.** Review formula clauses in existing documents that may have made sense when exemptions level were lower but now could inadvertently have the effect of leaving most of the estate to a credit shelter trust that would no longer save estate tax at the surviving spouse's death (and would prevent a basis adjustment at the spouse's death) or have other unexpected effects.

c. **Changes to Existing Trusts.** Clients who are no longer subject to transfer taxes may wish to modify existing trusts that are designed to save transfer taxes. A client may want the assets to be distributed to beneficiaries, believing that minimizing 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 life and obtain a basis adjustment at 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 purchase "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 continue paying income tax 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?

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 by 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 that there might be 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) the applicability of 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 in the portability decision, the 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 an estate of any size 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 may involve a single QTIP trust or multiple QTIP trusts (for example, if a state estate tax applies with an exemption different from the federal estate tax exclusion amount). An advantage of the single QTIP drafting approach is that the client (hopefully) can understand it, recognizing that it leaves a great deal of flexibility after the first spouse's death.

   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 through 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 (October 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**.

Items 9-13 highlight some important administrative pronouncements from the IRS and FinCEN.

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

a. **Executive Pronouncements.** The first Trump administration established a "one-in, two-out" system for regulations, requiring that for each new regulation, agencies identify at least two regulaltions to repeal in order to reduce the net regulatory costs. It also ordered a review of all "significant tax regulations" that impose undue financial burden or complexity or that exceed the statutory authority of the IRS and required review of IRS regulations by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA).

   The Biden administration ended the OIRA review of IRS regulations.

The second Trump administration, in Executive Order 14192, dated Jan. 31, 2026, reinstated the OIRA review of proposed regulations and directed agencies to identify 10 regulations to be repealed for each new proposed regulation. Executive Order 14219, dated Feb. 19, 2025, charges agency heads with identifying regulations meeting certain conditions, including those that extend beyond legislative authority and other situations encompassed by the *Loper Bright* decision. It also directs agencies to "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."

An April 2025 Presidential Memorandum required federal agencies to identify unlawful regulations within 60 days and take steps to repeal them without notice and comment. That Memorandum suggested that we will see 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." Jasper Cummings, Jr., *Latest Priority Guidance Plan is New in Every Sense*, 187 1025 TAX NOTES FEDERAL (May 12, 2025). Indeed, as discussed below, the 2025-2026 Priority Guidance includes 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.

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

For a more detailed discussion of these executive directives, see Item 12 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

b. **2025-2026 Treasury-IRS Priority Guidance Plan.** The 2025-2026 Treasury-IRS Priority Guidance Plan (dated September 30, 2025) sets the priorities 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 from 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 OBBBA; (2) deregulation and burden reduction; (3) Tribal tax issues; (4) digital assets; and (5) the SECURE 2.0 Act. Many projects that were on the 2024-2025 Plan are not included in the new Plan because they do not fit into one of those focus categories. The 2025-2026 Plan notes that "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 the 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 refers to. Perhaps it is the anti-abuse exception for the anti-clawback regulation, 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 from 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." For a discussion of the proposed regulations about

the anti-clawback special rule, see Item 14 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

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. For discussions of the items in the "Gifts and Estates and Trusts' section of the 2024-2025 and 2023-2024 Priority Guidance Plans, see Item 12.a-g of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

c. **2026 Letter Rulings Fees.** Revenue Procedure 2026-1, issued Dec. 29, 2025, describes the procedures for obtaining letters rulings in 2026. The fee schedule lists filing fees of $14,500 for 9100 relief rulings and $43,700 for most other letter rulings. (These compare to the 2025 filing fees of $12,600 and $38,000, respectively.)

d. **"No Rulings" List; Decanting.** Revenue Procedure 2026-3, issued Dec. 29, 2025, is the "no rulings" Rev. Proc. for 2026. One significant change is that several items regarding decanting transactions have been moved from the section for "Areas under study in which rulings will not be issued" to the section for "Areas in which rulings will not ordinarily be issued" (perhaps suggesting that the decanting issues are no longer under study?).

e. **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 2026 were announced in Rev. Proc. 2025-32. 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 four years (2022-2025);
- Estates and trusts taxable income for the 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;
- Taxable income threshold for §199A qualified business income – $403,500/$201,750 (married filing jointly/single) in 2026, $394,600/$197,300 in 2025;
- Standard deduction – $32,200/$16,100 (married filing jointly/single) in 2026, $30,000/$15,000 in 2025;
- Non-citizen spouse annual gift tax exclusion – $194,000 in 2026, $190,000 in 2025;
- Section 6166 "two percent amount" – $1,940,000 in 2026, $1,900,000 in 2025; and
- Special use valuation reduction limitation – $1,460,000 in 2026, $1,420,000 in 2025.

10. 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, subject to 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 must 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).

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**.

c. **Revised Form 8971.** The new Form 8971 and Schedule A (Rev. Aug. 2025) were released to align with final regulations issued in September 2024. Key changes in the 2025 revision include removal of the zero basis rule, reporting only distributed assets, flexible time of reporting until the executor determines assets to be distributed to each beneficiary, supplemental form rules to report subsequent distributions or to make corrections, and relaxed reporting requirements for related transferees.

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

As the IRS moves towards going paperless in the future, the IRS has revised estate and gift tax returns.

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).

a. **Form 709.** 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. As one panelist at Heckerling quipped, "The IRS decided the old form was way too straightforward." Some of the main changes are summarized.

(1) **General Information (Part I).** Part I has been reorganized. The following are several miscellaneous comments.

Address entries include foreign address options.

Line 15 has been added to check whether the return is an amended return. Writing "Supplemental Information" across the top of the return is no longer required. (The amended return must still include a statement of what changed, supporting information, and a copy of the original return.)

(2) **Gift Splitting.** Lines 12-18, regarding gift splitting, have been replaced by a single Line 19. Additional gift splitting information has been moved to a new Part III.

(a) **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 in which one spouse makes gifts and the other spouse consents to gift splitting, it seems as though this question answered literally would be "No." This is 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, as in many cases, when both spouses do not make gifts to third parties, the question should nevertheless be answered "Yes." Further, in many cases when both spouses do make gifts to third parties, but gift splitting is not intended, 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.

(b) **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.

(3) **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). This is 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.)

(4) **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.

(5) **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.

b. **Form 706.** 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 has Parts I-VI only, not the Schedules.
- 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.
- Because the Schedules and Form 706 are not part of the same package (making it easier for the IRS to amend a Schedule without having to amend an entire Form 706 package with all schedules), planners will need to verify that they are using the most updated version of relevant Schedules.
- Part I, Line 13 has a box to check for a "supplemental return."
- A universal continuation sheet for any of the Form 706 schedules is provided as new Schedule W.
- The Instructions to Form 706 (Sept. 2025) state that the estate tax closing letter fee has been reduced from $67 to $56. Closing letters are not sent automatically. "To make an ETCL request you must go to Pay.gov to submit a request and pay the user fee."

See Paul Hood, *Form 706: Ten Critical Updates for Estate Tax Filers*, LEIMBERG ESTATE PLANNING NEWSLETTER # 3274 (Feb. 13, 2026); 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).

12. "Postmark Rule" and U.S. Postal Service Clarification of When Postmarks Are Applied

a. **Section 7502, the "Postmark Rule."** Section 7502 provides that if a tax return, payment, or other required document is mailed to the IRS (or other appropriate agency) in a properly addressed envelope with sufficient postage, and the envelope is postmarked by the U.S. Postal Service on or before the due date, the document or payment is considered timely filed or paid – even if the IRS receives it after the deadline.

b. **Clarification from U.S. Postal Service of When Postmarks Are Applied.** The U.S. Postal Service published a final rule, Postmarks and Postal Possession, in the Federal Register on Nov. 24, 2025, effective Dec 24, 2025. 39 CFR Part 111, §608.11, **https://www.federalregister.gov/documents/2025/11/24/2025-20740/postmarks-and-postal-possession**. The preamble to the final rule warns that the placing of a postmark is not necessarily "the date on which the Postal Service first accepted possession of a mailpiece" and that the greater reliance by the Postal Service on processing centers will result in this difference between the time of acceptance to the time of posting a postmark becoming "more common." The final rule states that "postmarks are generally applied by the Postal Service via automation on machines in originating processing facilities but may also be applied manually by Postal Service personnel at those facilities, or by a Postal Service employee at a retail unit when a customer presents a mailpiece at a retail counter and requests a postmark."

c. **Practice Implications.** Clients must understand that "mailed on time" is not the same as "postmarked on time." To assure the date of the postmark, an individual can deliver the mail to a post office and request an employee at the post office to manually place the postmark on the envelope or request the local post office employee to affix a postage validation imprint label. "These labels indicate the postage paid for a mailpiece and, like manual (local) postmarks applied at retail locations, indicate the location of the retail unit at which the postmark is applied and the date on which the mailpiece was accepted at that unit." To ensure proof of mailing after using one of those two methods, the individual might also purchase a certificate of mailing (costing $2.40 in addition to the postage).

While most documents filed with the IRS are sent by traditional first-class mail, prudent advisers may mail documents using certified mail with a return receipt or by an authorized private delivery service.

13. Corporate Transparency Act Overview; BOI Reporting Applies Only to Foreign Reporting Companies (Interim Final Rule Mar. 23, 2025; Announcement Sept. 30, 2025); Residential Real Estate Reporting Delayed Indefinitely

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; *National Small Business United v. Dept of Treasury*, No. 24-10736 (11th Cir. Dec. 16, 2025).** One federal circuit level court has addressed the constitutionality of the CTA. An Alabama district court ruled that the CTA was unconstitutional because it "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 examined 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, focusing primarily on the Commerce Clause. *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 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 and that "[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).

e. **Other Cases Addressing Constitutionality of CTA.** For a summary of other cases and FinCEN statements addressing the constitutionality of the CTA, see Item 19.d of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

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 are required to file 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 certain residential real estate transfers (including gifts or transfers for cash or using private financing) to trusts or entities must 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 were effective December 1, 2025, but FinCEN released an announcement on September 30, 2025, delaying the reporting requirements for residential real estate until March 1, 2026, "to provide industry with more time to comply—consistent with the Administration's agenda to reduce compliance burden." FinCEN's website (**https://www.fincen.gov/rre**) on March 23, 2026 posted: "**ALERT:** In light of a federal court decision, reporting persons are not currently required to file real estate reports with FinCEN and are not subject to liability if they fail to do so while the order remains in force." (That case is *Flowers Title Cos. LLC v. Bessent*, discussed below.)

(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" (the description of beneficial owners is similar to descriptions required by 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 did 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 clarify and 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 an 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).

A detailed Frequently Asked Questions webpage is available on the FinCEN website, at **https://www.fincen.gov/rre-faqs**.

(4) **Examples of Transfers Not Excepted.** Because the trust exception applies only to gifts to trusts, sales to grantor trusts and transfers in which the trust accepts property subject to a mortgage would be reportable. Also, all transfers to entities are reportable (there is no exception for gifts), and residential property is frequently conveyed to an LLC before estate planning transfers are made.

(5) ***Flowers Title Cos. LLC v. Bessent*; Suspension of Reporting Requirements.** On March 19, 2026, a Texas federal district court vacated the reporting requirements for residential real estate non-financed transfers. FinCEN argued that several provisions in the Bank Secrecy Act authorized FinCEN's promulgation of the reporting requirements. The court disagreed.

> The first provision, 31 U.S.C. § 5319(g)(1), permits FinCEN to require reports of "any suspicious transaction." But the agency fails to explain or show how non-financed residential real estate transactions are categorically "suspicious." The second provision, 31 U.S.C. § 5318(a)(2), gives FinCEN the authority to require financial institutions to maintain "procedures" to comply with the act, not the authority to require the reports covered by the Final Rule.

The court found FinCEN's explanations to be "vague, conclusory, and unpersuasive." The court upheld the plaintiff's motion for summary judgment, holding that "(1) the Final Rule conflicts with the unambiguous terms of the Bank Secrecy Act and (2) vacatur and remand is the proper remedy." The effect of the "vacatur" was to vacate the reporting requirements across the country. *Flowers Title Cos. LLC v. Bessent*, No. 6:25-cv-00127 (E.D. Tex. Mar. 19, 2026).

In response, FinCEN's website on March 23, 2026 posted, "**ALERT:** In light of a federal court decision, reporting persons are not currently required to file real estate reports with FinCEN and are not subject to liability if they fail to do so while the order remains in force."

FinCEN will likely appeal the *Flower Title Cos.* decision. Vacating agency actions for all persons, not just the petitioners (sometimes called a ":universal vacatur"), has been controversial. The Supreme Court refused to enforce a universal vacatur in *Trump v. CASA, Inc.*, 606 U.S. 831 (June 27, 2025), holding 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. That case is discussed in Item 23.d of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(6) **More Detailed Discussion.** For a more detailed discussion about the reporting requirements for residential real estate non-financed transfers see Item 8.g 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**.

Items 14-24 include musings from some of the presentations at the 2026 Heckerling Institute.

14. Updating of Conflict of Laws in Trusts and Estates – Projects by Uniform Law Commission and American Law Institute

Comments in this item are from an excellent presentation by Professor Robert Sitkoff (Harvard University) at the 60th Heckerling Institute on Estate Planning.

a. **Overview: Why "Conflict of Trust Laws" Matters.** Conflict of trust laws arise when a trust has meaningful contacts with more than one state and the potentially applicable trust law rules differ; conflicts doctrine supplies the rules for selecting which state's law applies to a particular issue. There

are five reasons why this is becoming increasingly important. (i) increasing divergence in state trust law (e.g., perpetual trusts, asset-protection trusts, directed trusts, decanting, silent trusts, private trust companies), (ii) geographic dispersion of settlors, fiduciaries, and beneficiaries, (iii) intentional multi-state planning to create (or exploit) conflicts, (iv) the obsolescence/complexity of the Restatement (Second) of Conflict of Laws framework, and (v) active law-reform efforts to modernize the regime.

Two coordinated law reform projects are underway: a Uniform Law project and the Restatement (Third) of Conflict of Laws (which include a chapter on trust conflict of laws issues). UNIF. CONFLICT OF LAWS IN TRS. AND ESTS. ACT (Unif. L. Comm'n, Draft Oct. 24-25, 2025); RESTATEMENT (THIRD) OF CONFLICT OF LAWS (Am. L. Inst., Tentative Draft No. 3, Mar. 2022). Both projects may be finalized in the summer of 2026. Even for states that do not adopt the Uniform Act, courts typically cite and follow the Restatement, so this development is very significant. Unless provided otherwise, a reference to the "Uniform Act" in this discussion is a reference to the Uniform Conflict of Laws in Trusts and Estates Act that is in progress.

b. **Prevailing "Locational Anchors" Regime from The Restatement (Second) of Conflict of Laws.** The Restatement (Second) approach was developed in an era when families and fiduciary services were comparatively local and state trust law was perceived as relatively uniform—so true conflicts questions arose less frequently.

When conflicts did arise, the framework often relied on locational anchors, including:

- Situs of land (for trusts involving real property),
- Probate court involvement (because testamentary trusts were more common), and
- Other judicial supervision and formal accountings (making "where the court is" a practical anchor).

c. **Social and Trust Law Changes That Have "Unmoored" the Anchors.**

(1) **Social/Market Changes.** Important social/market changes are (i) the geographic separation of families, (ii) the shift to financial assets and the reduced centrality of land as a store of wealth (often land is held in entities), and (iii) nationalization of financial services.

(2) **Trust Law Changes.** Several developments increase conflicts frequency and stakes: meaningful state-by-state divergence on major trust features (examples – perpetual trusts, asset protection trusts, decanting, directed trusts, silent trusts, trust protectors, etc., the rise of inter vivos trusts relative to testamentary trusts, and the general move away from routine court supervision toward informal administration).

(3) **Impact of These Changes on the Existing "Locational Anchors" Regime of the Second Restatement.** Once locational anchors fade, planners confront a highly complicated classification system (real vs. personal property; inter vivos vs. testamentary; and "issue categorization" (validity, administration, interpretation/construction, restraints on alienation, and powers of appointment).

d. **The Uniform Act / Restatement (Third) Approach.**

(1) **Core Objective: Simplify Categories; Clarify Defaults.** The reform project starts from the premise that practice cannot "go back" to the old anchors and therefore must: (i) reduce the number of categories, (ii) simplify rules within each category, and (iii) state clear outcomes when the instrument is silent, including clearer rules on validity and administration (especially identifying the place of administration).

(2) **Real vs. Personal Property and Inter Vivos vs. Testamentary Trust Distinctions Eliminated.** Real property and personal property are generally treated together. Similarly, inter vivos and testamentary trusts are generally treated together, with appropriate timing differences (e.g., domicile measured at death vs. at execution/creation).

(3) **Issue-by-Issue Distinctions Generally.** Conflicts issues arise for important issues – validity, administration, interpretation, construction, restraints on alienation, and powers of appointment. Some distinctions in the rules will continue to apply for these various issues, but the goal is to reduce distinctions to the extent it can reasonably be done. As a general rule, absent a choice by the donor, governing law will track the donor's domicile, except that administrative matters are keyed to the place of administration.

(4) **Construction and Interpretation.** Construction and interpretation are treated the same. Historically, interpretation focused on discerning intent (including extrinsic evidence, plain meaning, reformation), while construction supplied gap-fillers (e.g., lapse, divorce, and revocation defaults). The reform approach treats these together: the donor/settlor's choice generally controls, with forum evidence rules remaining matters of procedure (for example, rules about authenticity, best evidence, and hearsay). For construction/interpretation issues, any state law can be selected, and the trust does not have to have any connection with that state. After all, the trust agreement can clarify directly what is meant by terms in the trust. If no governing law is designated, domicile law governs.

(5) **Validity.** Issues regarding validity arise in three contexts. Those are –

- **Formal Validity (Execution Formalities).** A trust is treated as formally valid if it satisfies the formalities of any materially connected jurisdiction (e.g., domicile/residence, domicile, abode, nationality, location of fiduciary, or location of property).
- **Capacity/Consent (Undue Influence, Fraud).** The donor's domicile is emphasized as the key connecting factor, reflecting the state's interest in policing capacity and consent.
- **Substantive Validity.** Substantive validity issues (such as issues relating to trust creation, duration, asset protection, restraints on alienation, etc.) are the most important validity issues for which conflict of law issues arise and can be critically important to planners.

(a) **Uniform Act Approach for Substantive Validity Issues.** Donor choice of law regarding validity issues is respected if the chosen state has a **substantial relation** to the trust (e.g., trustee's domicile or place of business) and the selection does not violate **a strong public policy** of the state with the most significant connection to the trust as to the matter at issue; if no choice is made, the default looks to the state with the **most significant connection** to the particular issue. (This is consistent with current law.)

(b) **Substantial Relation.** Uniform Act § 211 lists several factors for determining if a state has a substantial relation to a trust, including [but not limited to] the principal place of administration, domicile of the settlor, domicile or place of business of a trustee or trust director, or the domicile of any beneficiary whose interest is affect by the matter at issue.

(c) **Strong Public Policy.** The reform projects do not attempt to address how to determine if a state has a "strong public policy"; that would be a limitation under general conflict of laws principles and is a constitutional limitation on selecting the governing law. The comments to §204 of the Uniform Act state that a "strong public policy" means something more than a different law in the other state. Rather, a "strong public policy" of a state would more appropriately be understood to be "some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal." *Loucks v. Standard Oil Co. of N.Y.*, 120 N.E. 198, 202 (N.Y. 1918) (Cardozo, J.).

(d) **Most Significant Connection**. The Uniform Act includes guidance about determining which state has the "most significant connection" to an issue by listing general factors that should be considered (principal place of administration, location and nature of the trust property at issue, domicile of the settlor, domicile or place of business of a trustee or trust director, and the domicile of any beneficiary whose interest is affected by the matter at issue) as well as the justifiable expectation of any interested party and the policies underlying trust law and any other field of the law relevant to the matter at issue. Uniform Act § 210.

(6) **Administration (Often the Hardest Category in Practice).** Unlike validity and many interpretive questions, administration problems recur over time and are difficult to "lock down" at inception.

Administration issues include pretty much everything related to the exercise of trustee powers and duties, such as discretionary distributions, principal/income issues, decanting, modification (states vary regarding the significance of the trust's material purpose), reformation, merger, investment changes, directed trusts (including the liability standard for following the director's directions), silent trusts, fiduciary liability, exculpation, trust protectors, trustee removal, remedies for breach of trust, beneficiary consent, accounting reports, virtual representation, termination procedures, and mediation.

(a) **General Approach.** The reform projects have adopted the following general approach as to administration issues (see Uniform Act § 206).

- First: apply the law named by the settlor for administration if the chosen state has a substantial relation (e.g., a trustee in that state).
- Second: administrative governing law can change if the principal place of administration changes, unless the instrument clearly "locks" administration law notwithstanding a move.
- Third: if the settlor is silent, apply the law of the principal place of administration.
- Fourth: Where multiple states could exercise jurisdiction (e.g., because trustees are amenable to service in more than one place), when should the courts outside the principal place of administration defer (or when can they defer) to courts of the principal place of administration? Uniform Act § 209. (This approach is more workable under the reform projects because they include clearer rules for determining the "principal place of administration.")

(b) **Principal Place of Administration (Identification Problem).** Identifying the principal place of administration is a persistent difficulty in modern structures (with multiple trustees, trust directors/protectors/advisors across jurisdictions and bank operations in multiple locations). Prior uniform acts and restatement projects have "chickened out" by deferring the issue to the background and not establishing guidelines for determining the principal place of administration.

The approach of the Uniform Act and Restatement reform projects is to provide: (i) a safe harbor for a settlor designation if a fiduciary is in the named state, (ii) a mechanism for trustees to designate the place of administration in writing, and (iii) a default test looking to where the most active trustee/trust officer is located if no designation exists. (Prof. Sitkoff believes that is a significant advance compared to existing law regarding the determination of the principal place of administration.)

(7) **Powers of Appointment.** The Uniform Act provides rules to identify the applicable law to govern the exercise of a power of appointment (formal and substantive validity of the exercise, which includes capacity, consent, and substantive rules implicated by the exercise of the power, such as the rule against perpetuities). Uniform Act, Article 4.

e. **Governing Law Clauses: Practical Drafting Focus.**

(1) **The "Mismatch" Problem.** In interpreting governing law clauses, a recurring mismatch occurs between common formbook language ("governed by," "meaning and effect," "administered under") and the conflict of laws framework's category-specific analysis (validity vs. construction/interpretation vs. administration). For example, if a clause that says "this trust is to be administered under the laws of state x," is that selection of law meant to apply only for matters of administration or should it apply for all matters relating to the trust if there is no other governing law provision in the trust agreement? The Uniform Act says that "governed by" will presumptively include all three categories of issues.

(2) **Uniform Act Treatment of Existing Clauses.** For existing trusts, clauses stating that the trust is "governed by" a state's law (or similar broad phrasing) are treated as intending to apply broadly

across all issue categories, but such clauses generally are not read to permanently freeze the law of administration if the principal place of administration later changes.

(3) **Drafting Going Forward.** Trust governing law clauses should explicitly address which categories (validity, construction/interpretation, and administration) are covered—separately and clearly—rather than treating governing law as an afterthought. Different state laws may be selected for varying issues. The Uniform Act and new Restatement are coming, but they are not here yet (and some states will take years to adopt the Uniform Act). In the meantime, draft around the potential problems. The Uniform Act provides a checklist of potential conflict problems that can arise and a checklist of how to draft around the uncertainty.

f. **Takeaways for Estate Planning Practitioners.**

(1) **Not Boilerplate.** Treat governing law as a core design variable, not boilerplate**.** Analyze (and draft for) the separate categories of validity, construction/interpretation, and administration, recognizing that different connecting factors and dynamics may change over time.

(2) **Commonplace.** Assume conflicts questions will arise, often intentionally. Multi-state fiduciary structures and dispersed family/property contacts should make conflicts analysis a routine part of modern planning.

(3) **Drafting.** Draft "around" the Restatement (Second) while reform is pending. The Uniform Act framework is a practical checklist of the conflicts issues that can arise—and therefore a checklist for what to address explicitly in drafting today.

15. Qualified Small Business Stock (QSBS) Expansion Under OBBBA and Planning Opportunities

a. **Significance; Brief Overview of QSBS Exclusion.** Shareholders in a C corporation have a very significant opportunity to sell the stock and exclude a substantial portion (if not all) of the gain on the sale of the stock – if the stock qualifies as qualified small business stock (QSBS) under §1202. Gain exclusion under §1202 was first enacted in 1993, but the opportunities to use the exclusion were limited for decades. In recent years, the opportunities for gain exclusion have become much more significant, and they were expanded further in the One Big Beautiful Bill Act (the Act). Some of the general requirements to qualify under §1202 are that (1) the shareholder must not be a corporation, (2) the issuer must be a domestic C corporation, (3) the stock must have been originally issued after August 10, 1993, (4) the shareholder must have acquired the stock at original issue from the corporation in exchange for money or other property (not stock) or as compensation for services (including gifts or bequests of these shares), and (5) over 80 percent (by value) of assets must be used in the active conduct of one or more qualified trades or businesses.

If QSBS is sold with a 100% QSBS exclusion, the eligible gain (i.e., gain up to the amount of the per-issuer limitation, discussed below) is completely excluded from income and is also not subject to the 3.8% net investment income tax. The portion of any eligible gain that is not excluded under the QSBS exclusion (i.e., because it has been held less than five years) is subject to a 28% long-term capital gains rate and the NII Tax (or a blended rate of 31.8%).

b. **Expansion of Qualified Small Business Stock Gain Exclusion Under the Act.** Prior to 2026, §1202 provided for the exclusion of 100%, 75%, or 50% (depending on when the stock was acquired) of gain on the sale of QSBS held more than five years. The exclusion was subject to a per-issuer cap—generally the greater of $10 million or 10 times the basis in the stock. Eligibility also depended 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 4, 2025 (the date of enactment).

- (1) Tiered gain exclusion – the tiered eligible 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 limitation; increase of dollar cap – the per-issuer limitation for each taxpayer has two mutually exclusive limitations: (i) the "applicable dollar cap," which is increased in the Act from $10 million to $15 million (indexed for inflation beginning in 2027); and (ii) "10 times the aggregate basis of QSBS issued by such corporation and disposed by the taxpayer during the taxable year" (the "10 times basis limitation"). The 10 times basis limitation was not changed in the Act.
- (3) Aggregate gross asset threshold – the corporate-level aggregate-asset ceiling is increased from $50 million to $75 million, indexed for inflation beginning in 2027. The $75 million limit is retroactive, meaning that even though the corporation may have exceeded the $50 million gross asset threshold at any point (which would have disqualified the corporation for QSBS treatment thereafter for all shareholders under prior law) but never exceeded the $75 million threshold, the corporation satisfies the gross asset value limitation. These changes are effective for taxable years beginning after July 4, 2025.

These three changes are very significant for small business owners (and, as discussed below, for even very valuable businesses with appropriate planning). 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).

For planning considerations with QSBS 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) and Jeremy Brown, Jennifer Smith, & Todd Steinberg, *A Primer on Qualified Small Business Stock and Planning, Post – OBBBA*, FINESCA WASHINGTON REPORT (Dec. 11, 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).

c. **"Stacking" To Maximize Qualification Under the $15 Million Dollar-Cap Exclusion Limitation.** The $15 million applicable dollar cap is reduced by prior sales of QSBS from the same issuer. As the applicable dollar cap is utilized, the ten times basis rule will be more important for measuring the eligible gain for subsequent sales of QSBS from that issuer.

The dollar cap is limited to $10 million for stock issued before July 4, 2025, even when those shares are sold after July 4, 2025. Shareholders of shares issued both before and after July 4, 2025 cannot "double dip" to exclude $10 million of gain for the pre-July 4, 2025 shares and an additional $15 million of gain for the post-July 4, 2025 shares.

If a taxpayer has excluded gain of QSBS from a particular corporation in any year exceeding the dollar cap for that tax year, that shareholder is not eligible for additional exclusion under inflation adjustments to the dollar cap for sales of QSBS from that issuer in later tax years. (However, the shareholder may qualify under the mutually exclusive 10 times basis limitation.)

Spouses generally must share the dollar cap. For example, married individuals filing separate returns would each be entitled to a $7.5 million dollar cap for stock issued after July 4, 2025.

Having multiple non-grantor trusts own QSBS stock becomes more important for "stacking" of QSBS with the increased $15 million dollar cap. The multiple trust rule of §643(f) would treat multiple trusts as a single trust if (1) they have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trust is the avoidance of a tax. Separate trusts that have different primary beneficiaries (e.g., a separate trust for each of the grantor's children) should not be aggregated under the multiple trust rule.

A planning alternative to minimize the gift exclusion amount required to cover transfers of QSBS 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. Another alternative is to use "incomplete gift, non-grantor trusts" (ING trusts).

d. **New Focus of "Packing" To Maximize Qualification Under the Ten Times Basis Limitation and the Aggregate Gross Asset Value Limitation.**

(1) **Ten Times Basis Limit.** For purposes of the 10 times basis limitation, if property (other than money or stock) was contributed to the corporation in exchange for the issuance of QSBS, the basis of the shares is determined using the fair market value of the property when contributed rather than just the basis of such property (in addition to the amount of money contributed in exchange for the issuance of the stock). If stock is issued in return for a contribution of appreciated property worth $50 million, the 10 times basis limitation would be $500 million. When the stock is sold, recognized gain would be determined using the stock's lower basis derived from the carryover basis of the property contributed, but in determining the amount of the gain that can be excluded under §1202, the 10 times basis limitation would be determined using the fair market value of property contributed to the corporation in exchange for issuance of the stock.

Unlike the dollar cap limitation, the 10 times basis limitation is not "used up" with prior sales. The limitation is 10 times the basis of the shares being sold, regardless how much gain has been excluded in prior sales of QSBS from that issuer.

The basis is determined "without regard to any addition to basis after the date on which such stock was originally issued." §1202(b)(1), flush language. Therefore, a step-up in basis under §1014(a) would not add to the basis of the stock for purposes of the 10 times basis limitation when the stock is later sold by recipients from the decedent.

Planning Tip: Dispose of low-basis stock before disposing of high-basis stock. The initial sale of low-basis stock will mean that the full amount of the $15 million dollar cap will be available to exclude gain, and the subsequent sale of high-basis stock will likely be covered by the 10 times basis limitation. If the high basis stock is sold first, all of the gain would likely be excluded under the 10 times basis limitation, but the sale would have "used up" the dollar cap; the subsequent sale of the low-basis stock would not have the dollar cap that had been utilized previously, and the 10 times basis limitation may not be large enough to cover all the gain.

Planning Tip: Consider selling high-basis QSBS shares that have not been held for the requisite holding period in the same year for selling QSBS that has been held for the requisite holding period. The basis of all QSBS shares sold during the year is considered for the 10 times basis test (including basis of the shares not held for the requisite holding period), which might exclude all of the gain on the QSBS held for the requisite holding period. (The obvious disadvantage is the loss of the potential gain exclusion for the QSBS that is sold before being held for the 3, 4, or 5-year holding period.) For example, an individual might exercise an option to purchase stock, recognizing ordinary income (and thus generating basis) in an amount equal to the difference between the stock value and the exercise price. The individual might choose to sell those shares (which would have nominal gain and would not meet the 3-year holding period) and in the same year sell low-basis highly appreciated QSBS held for more than 5 years. The basis of all such QSBS shares sold in that year would be counted for applying the 10 times basis limitation.

Planning Tip: The company may start as an LLC (so that losses that are incurred in the beginning years of the business can be deducted by the owners on their individual returns) and later convert to a C corporation or C corporation tax status by a check-the-box election. The value of the enterprise (using contemporaneous valuation appraisals) is treated as the basis of the owners' interests for purposes of the 10 times basis limitation. (For example, if the enterprise value is $40 million at the time of conversion, the 10 times basis limitation would be $400 million of gain that could be excluded.)

(2) **Aggregate Gross Assets Threshold.** The term "aggregate gross assets" sounds like a gross value test, but the $75 million threshold is the *basis* of the corporation's assets, with some special rules. "The term 'aggregate gross assets' means the amount of cash and the aggregate bases of other property held by the corporation." §1202(d)(2)(A). For that purpose, however, the adjusted basis of any property contributed to the corporation is determined "as if the basis of the

property contributed to the corporation (immediately after such contribution) were equal to its fair market value as of the time of such contribution." §1202(d)(2)(B). For example, if a corporation is formed with a contribution of property worth $60 million, the shares issued for that contribution would be eligible for QSBS status (the aggregate gross asset value is under $75 million), but if the corporation subsequently raises $30 million of cash in a financing, the basis in its assets after the capital raise would be $90 million, thus exceeding the $75 million limit, and none of the corporation's shares issued thereafter would thereafter qualify for QSBS treatment.

The changes in the Act allowing immediate expensing of domestic research or experimental expenditures (§174A) and 100% bonus depreciation for eligible qualified property under §168(k) are enormously important for packing planning to qualify under the $75 million gross asset limitation and to make use of the 10 times basis limitation. For many technology development companies, the largest expense is the salary of developers, and those amounts can be deducted immediately. For AI companies building data farms, the building expenses could be depreciated immediately (OBBBA allows 100% bonus depreciation for eligible qualified property). This means that infusions of capital in various rounds of financing would each add to the basis of the contributors' stock for purposes of the 10 times basis limitation, but the aggregate gross value of the corporation would remain fairly static because the additional contributions would be used for a purpose that could be immediately expensed, thereby minimizing or eliminating any increase in, the basis of the corporation's assets. For example, if the shareholders contribute serial rounds of funding of $10, $20, $40, and $80 million, the contributing shareholders would have a basis of $150 million, resulting in possible exclusion of 10 times that, or $1.5 billion, but the basis of the company's assets (i.e., the aggregate gross asset value) might remain well below $75 million at all times if the investments were used for immediately deductible salaries or building expenses.

16. IRA and Retirement Plan Distributions for Surviving Spouse; Conduit QTIP Trust; Failure To Make RMDs

Comments in this item are from an excellent presentation by Natalie Choate at the 60th Heckerling Institute on Estate Planning.

a. **Brief Overview of SECURE Act Limitations.** Required minimum distributions (RMDs) to beneficiaries of retirement benefits must be made within certain term periods. If the beneficiary is not an individual (i.e., is not a "designated beneficiary"), distributions must be made over 5 years if the owner dies before her required beginning date (RBD) (currently age 73 under SECURE 2.0) or over the deceased owner's "ghost life expectancy" if she died after her RBD. If the beneficiary is a designated beneficiary (an individual or a trust that is treated as an individual), benefits must be paid over 10 years, except that for five categories of "eligible designated beneficiaries" (EDBs), distributions may be made over longer periods. One of the categories of EDBs is the owner's surviving spouse, and distributions to the spouse may be made over the spouse's life expectancy.

b. **Trust for Spouse as Beneficiary Generally.** If the beneficiary of a retirement plan is a traditional trust for the benefit of a spouse during the spouse's lifetime and that passes to other individuals at the spouse's death, the trust does not qualify as an EDB. Therefore, distributions from the plan must be made to the trust beneficiary over 10 years following the owner's death. A lifetime payout is generally much more desirable – to assure that benefits will be available over the spouse's lifetime and to delay when income taxes must be paid on the retirement benefits as they are distributed.

c. **Conduit QTIP Trust.** A "conduit trust" is a see-through trust requiring that all distributions from a plan to the trust "will, upon receipt by the trustee, be paid directly to, or for the benefit of, specified beneficiaries." A conduit trust for a surviving spouse is treated as passing to the surviving spouse. This means that the spousal EDB exception applies for the outer limit, and special rules apply delaying when distributions must be made to the trust (discussed below).

   The trust would have standard QTIP terms (including the required marital deduction provision that the trustee must at a minimum distribute all income from the plan each year), require that the RMD amount be withdrawn each year, AND require that the trustee distribute to or for the benefit of the spouse all amounts received from the plan (to qualify as a conduit trust). Natalie strongly suggests

that (unless the IRA owner really wants to limit distributions to the surviving spouse) the trust also provide that additional distributions may be made as the trustee determines advisable for support in the surviving spouse's accustomed standard of living because the RMD and income from the plan may both be very low.

Distributions from a conduit trust for a spouse may be delayed until the owner would have reached age 73, and life expectancy is recalculated annually. SECURE 2.0 makes a change in this regard – beginning in 2024, the conduit trust for the spouse may use the uniform life table (rather than the single life table) and may recalculate life expectancy annually for determining distributions over the spouse's life expectancy. (Those special benefits previously were available only if the spouse was the direct beneficiary of the plan and elected a spousal rollover.) SECURE 2.0 allows these added benefits for the spousal conduit trust only if the spouse makes an election for the rules to apply, but the IRS views the spouse as being *deemed* to make the election unless the spouse affirmatively elects otherwise.

d. **Payout Advantages for Conduit QTIP Trust.** The following special rules apply for spousal rollovers and for conduit spousal trusts.

   - Recalculate life expectancy annually (otherwise, benefits would be paid over the spouse's life expectancy at the owner's death, and no further distributions would be available if the spouse outlived her life expectancy).
   - The spouse does not have to start taking distributions until the decedent-owner would have reached her RBD (age 73).
   - Most important, the single life expectancy table does not apply, but the "uniform life table," which is based on the life expectancy of the person and someone 10 years younger, can be used; it is based on the life expectancy of the person and someone 10 years younger. (For example, if the spouse is age 75 when the owner dies, her single life expectancy payout would be 14.8 years, but the uniform life table payout would be 24.6 years (roughly, a 4 percent rather than a 7 percent payout in the first year, and the payout would not exceed 10 percent until the spouse is in her 90s).

e. **Convert Trust to a Conduit Trust After Owner's Death.** If the beneficiary of the plan at the owner's death is a traditional trust for the spouse (such as a traditional QTIP trust) and not a conduit trust (requiring immediate distributions from the trust to the spouse as plan benefits are paid to the trust), can the trust be converted to a conduit trust? Yes, if the change is made (by decanting or trust modification under state law) before the "beneficiary finalization date," which is September 30 of the year after the owner's death.

f. **Discharge from Liability for Failure To Make RMDs During Life.** Following the plan owner's death, the executor may not know for sure that all RMDs had been taken during the owner's lifetime. If that is the case, the executor can file Form 4810 to request prompt assessment of income, gift taxes, and excise taxes with respect to any returns filed by the decedent. That shortens the statute of limitations on a future assessment (or court proceeding without assessment for collection of tax) to 18 months from the date the request is filed. The request must specify the classes of tax and the taxable periods for which prompt assessment is requested. Reg. §301.6501(d)-1(b). The shorter statute of limitations under this section protects not just the executor from personal liability but also the estate and its beneficiaries.

g. **Further Discussion.** For more detailed discussions of planning considerations for trusts as beneficiaries of retirement plans 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 Item 4 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

17. Spousal Lifetime Access Trust Planning Musings

Spousal lifetime access trusts (SLATs), an irrevocable trust created by one spouse with the other spouse as a potential discretionary beneficiary, have become popular for spouses wanting to make transfers but keep the possibility of some access to the transferred fund for the spousal unit. (They were really the rage in 2024-2025 when donors were structuring plans to take advantage of the large gift exclusion amount in case it reverted to a $5 million (indexed) amount. They are not necessarily "the hot item" now.) Wide ranging issues must be navigated in structuring SLATs (including, very importantly, how the grantor might have potential access to trust assets following the donee-spouse's death), as discussed in Item 78 of ACTEC 2020 Annual Meeting Musings (Mar. 2020) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The following are several musings about SLAT planning.

a. **Potential Conflicts of Interest Between Spouses.** It is imperative that the planner consider possible conflicts of interest between the spouses. Transferring assets to a SLAT can result in a very significant shift of the relative ownership of marital assets as between the spouses and possible adverse implications if the spouses should later divorce. See Item 18 below.

b. **Review Tax Apportionment Clause.** In case a SLAT should be included in the donor's gross estate under §2036 (this is more of a concern if the spouses each create SLATs for each other, even though they are planned to be "non-reciprocal"), review the tax apportionment clause so the estate tax attributable to the SLAT inclusion is not allocated to the residuary estate, which might be passing largely or entirely to the surviving spouse to qualify for the marital deduction. The tax payment would decrease the marital deduction, which would further increase the tax, etc., resulting in a circular calculation, resulting in an even more significant estate tax.

c. **Similar Marital Deduction Mismatch Possibility for LPs/LLCs.** The marital deduction concern also applies to LP/LLC interests that might be included under §2036. The full asset value would be included in the estate, but a marital deduction may be allowed only for the discounted value of the LP/LLC interest. The IRS raised this issue in *Black v. Commissioner*, T.C. Memo. 2009-212, *Estate of Shurtz v. Commissioner*, T.C. Memo. 2010-21, and *Estate of Turner v. Commissioner*, T.C. Memo. 2011-209, but those cases did not have to address the issue because of other rulings in the cases.

d. **Continuing Grantor Trust Treatment Following Divorce.** The 2017 Tax Cuts and Jobs Act repealed §682; that section provided that if one spouse created a grantor trust for the benefit of the other spouse, following the divorce the trust income would not be taxed to the grantor-spouse under the grantor trust rules to the extent of any fiduciary accounting income that the donee-spouse is "entitled to receive." Because of the repeal of §682, the donor-spouse could be stuck paying income tax on income of the SLAT (if it continues with the ex-spouse as a potential beneficiary). This is one of the potential conflicts of interest between the spouses when SLATs are created.

   Alternatives for dealing with this concern include (1) providing that the spouse would no longer be a beneficiary following a divorce (perhaps by using a "floating spouse" provision in the trust agreement definition of "spouse"), (2) requiring adverse party consent to (or giving an adverse party veto power over) any distributions to the ex-spouse beneficiary following divorce (both (1) and (2) would mean the trust may no longer be a grantor trust following divorce), (3) including a reimbursement provision permitting the trustee in its discretion to reimburse the grantor for income taxes attributable to the SLAT income, or (4) having an agreement between the spouses as to how income taxes would be paid regarding SLAT income following a divorce.

e. **SWAP Power.** Giving the grantor a swap power over the SLAT assets may be helpful to (1) assure the trust is a grantor trust as to the entire trust, §675(4)(C), (2) give the grantor flexibility to "buy back" favored assets that were transferred to the SLAT, (3) reacquire highly appreciated assets so they may receive a step-up in basis at the grantor's death, and (4) address the grantor's liability for income taxes resulting from a sale of highly appreciated assets by having the grantor reacquire some or all of those assets before the sale (the grantor would still have the tax on the gain when the asset is sold, but the sale proceeds would be paid to the grantor and the grantor would have cash to pay the income tax).

18. Navigating the Ethical Minefield of Estate Planning with Married Couples

Comments in this item are observations from an excellent presentation by Bruce Stone, and a panel discussion by Bruce Stone, Elizabeth Carter, and Scott Rubin, at the 60th Heckerling Institute on Estate Planning.

a. **Significance Overview; Divorce Statistics.** Routine, sound estate planning advice for a married couple can have terrible consequences if the couple gets divorced. For example, even simple advice regarding joint ownership of property could later be contentious. Transfers of large amounts to trusts could be very contentious upon divorce.

Divorce statistics from the Centers for Disease Control and Protection: 42% of first marriages end in divorce (median duration of 8.2 years); 2/3rds of second marriages end in divorce; 3/4ths of third marriages end in divorce; 1/3 of "gray" marriages (over age 65) end in divorce. (The incidence of divorce may be significantly lower for couples with higher wealth accumulation, educational achievement, or longer marriage durations.)

Considering these statistics, does the lawyer have a duty to discuss with clients what they want to happen regarding planned transactions in the event of a divorce? There could be inherent conflicts of interest in that discussion (what is good for one spouse may be bad for the other spouse). Led to an extreme, that could suggest that the couple be represented by an estate planning attorney with each spouse having a family lawyer to advise about issues with potential conflicts, resulting in three attorneys for what seems at the outset to be routine estate planning. That is obviously unworkable, so what should estate planning attorneys do to protect the clients' interests and protect themselves?

Medical analogy: If a medication has a 40% chance of serious side effects, we expect the physician to discuss that risk. Similarly, should an attorney be expected to discuss ramifications of the possible "side effect" of a divorce when there is a 40% chance of divorce in a first marriage?

Following a divorce, the spouse disadvantaged by some estate planning transaction will ask why the attorney did not advise about the possibility of that bad result. "Are you stupid, or were you primarily looking out for the interests of my ex-spouse?"

Addressing the potentially disadvantageous impact upon a spouse in the joint estate planning discussion may be uncomfortable, and attorneys must address these issues in a gentle manner.

Admittedly, in many situations, there will be no problems. But in the one that blows up, it will be a major problem.

b. **Key Ethical Issues.**

(1) **Conflicts of Interest, Model Rule 1.7.** An attorney generally cannot represent a client if representation will be directly adverse to another client or there is a significant risk that the representation will be materially limited by representation of another client. However, a lawyer may represent clients in conflict situations if the lawyer believes she can provide competent and diligent representation to each client, if they are not in litigation, and if they give informed consent, confirmed in writing.

(2) **Communication, Model Rule 1.4.** A lawyer shall promptly inform the client of a circumstance for which informed consent is required, keep the client reasonably informed, and "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."

(3) **Confidentiality, Model Rule 1.6.** A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized to carry out the representation, or it falls under specific, limited exceptions. This duty extends to prospective and former clients, surviving the termination of the attorney-client relationship.

c. **Florida Bar Ethics Opinion 95-4 (May 30, 1997).**

(1) **Factual Scenario Overview.** The estate planning attorney jointly represents H and W to update their wills. Several months later, H tells the attorney he prepared a codicil to make a significant gift to a woman with whom he is having a long-term affair, and asks what will happen if W elects against the will? The attorney says he cannot advise H on that issue, and he might have to withdraw from the representation. H tells the attorney he will sue the attorney if he discloses the confidence to W.

The opinion recognizes that this situation raises disharmony between the attorney's duties of communication (to communicate to a client information that is relevant to the representation) and confidentiality (obligation to matin in confidence all information relating to the representation of a client).

(2) **Conclusions of Opinion 95-4.**

- Until H's communication about the codicil, there was no objective indication that the spouses' interests diverged or that a divergence of interests was reasonably likely to arise. Such situations do not trigger disclosure and consent requirements for a joint representation.
- The attorney was not ethically obligated to discuss the lawyer's obligations regarding separate confidences.
- The ethical obligation to H *prohibits* the lawyer from disclosing the information to W. The attorney cannot exercise discretion whether to disclose the separate confidence.
- The attorney must withdraw from the representation because of the adversity of interests that has arisen. Some conflicts can be cured by obtaining informed consent, but others, like this one, involve material limitations on representation of a client and the attorney cannot provide representation on the basis of informed consent.
- A sudden withdrawal almost certainly will raise suspicions by W. Nevertheless, the attorney must withdraw using the following script: "Lawyer should inform Wife and Husband that a conflict of interest has arisen that precludes Lawyer's continued representation of Wife and Husband in these matters. Lawyer may also advise both Wife and Husband that each should retain separate counsel."

(3) **Additional Observations About Best Practices Under Opinion 95-4.**

- Within Florida, many in the estate planning bar were uncomfortable with some of the conclusions in this ethics opinion.
- In withdrawing from representing the clients, do not elaborate even if questioned repeatedly. Respond to every question with "A conflict has arisen that precludes me from representing either of you."
- Send written notice separately to both spouses. (Separate email messages may be the best way to reach each of them.)
- The opinion leaves the attorney in a lurch. The attorney is prohibited by the Bar from communicating material facts to W because of ethical obligations. However, W may still sue the attorney for damages following a contentious divorce, claiming that if she had known about the other woman, she could have taken steps to protect herself. Bruce Stone asks, "how will the attorney's response that ethical rules did not allow disclosure play to the jury?"

d. **Joint Representation Best Practices.**

(1) **Engagement Letter.** The engagement letter should address these issues: (1) the nature of the joint representation, (2) no confidentiality between the spouses, (3) either spouse can terminate the information-sharing permission, but in that case, the attorney will decide in her sole professional judgment if a conflict of interest has arisen that prevents adequate representation of the other spouse, (4) if the attorney makes that determination, the attorney would not represent

either in their estate planning without the consent of both spouses, (5) even if a spouse revokes permission to disclose information, the attorney could still be compelled to testify about the information if there is subsequent litigation between the spouses, and (6) the scope of the representation ends when documents are executed. (The materials include a sample engagement letter from Bruce Stone.)

(2) **Potential Conflict Issues with SLATs.** SLATs present significant potential conflicts of interest between the spouses. These include (a) potential massive shift of marital property interests from the donor-spouse (the donor-spouse must transfer his separate assets, and the other spouse is benefitted by being a discretionary beneficiary of the SLAT), (b) income tax issues following divorce (the grantor continues to be taxed on trust income under the grantor trust rules), and (c) tax apportionment (if the SLAT assets are included in the grantor's estate, estate tax may be apportioned to other assets rather than the SLAT).

(3) **Discussion of Potential Conflict Issues.** Discuss consequences objectively, avoid discussing "pros" and "cons" but discuss "consequences," document the discussion thoroughly (preferably with a witness), and emphasize that "I cannot advocate for either of you." If spouses cannot agree, inform them that they may want to have separate counsel (but do not recommend specific attorneys) and that the estate planning attorney could draft the document if the spouses come to agreement (perhaps with independent counsel). The attorney should not answer "what would you do?" when a clear conflict exists.

e. **Marital Agreements.**

(1) **Significance of Having a Marital Agreement.** (a) "Everyone has a prenup – either you wrote it or your state legislature wrote it. Often, you can do better than what the law provides." (b) People move around; set the rules that will apply regardless of where the spouses move.

(2) **Significance of Having a Marital Agreement Where Premarital Debt Is Paid with Marital Property**. Having a marital agreement is very important if one spouse's premarital debt (such as student loan debt) is paid with the spouse's earnings (marital property). Under the laws of many states (particularly many community property states), but not in Florida, if one spouse's debt is paid with marital property, on divorce the other spouse will have a right to be reimbursed for half of the payments. This would be a huge crushing surprise on divorce. The spouse who paid his debt with his earnings would also have to pay the other spouse half of that amount. Coming to an agreement on how premarital debt will be paid during marriage is critical. (In Texas, that issue exists not only on divorce but also at death; the reimbursement is allowed if not doing so would result in "unjust enrichment," and equitable principles are applied in determining the amount of the reimbursement. TEX. FAMILY CODE §3.402. However, the reimbursement claim does not apply to the payment of student loan debt or child support.)

(3) **Leverage**. Prenuptial agreements involve more leverage than postnuptial agreements. Section 9 of the Uniform Premarital and Marital Agreements Act provides that an agreement is unenforceable if consent to the agreement was involuntary or the result of duress or if a party did not have reasonable time to secure legal representation (which is more of a concern for premarital agreements). If the time is too close to the wedding to do a prenuptial marital agreement, enter into a prenuptial agreement to do a postnuptial agreement with full disclosure (although as a practical matter, the postnuptial agreement may never get done).

(4) **Disclosure of Financial Information**. The Uniform Act has reduced disclosure requirements in Section 9(d), allowing a spouse to expressly waive, in a separate signed document, the right to financial disclosure beyond what has been provided. Despite that, the strong recommendation, especially for premarital agreements, is to make full disclosure. Some of the panelists said they would never do a prenuptial agreement without full disclosure. "There is no such thing as too much disclosure."

Full disclosure would include complete financial statements, trust documents or summaries of trust beneficial interests, valuations of trust discretionary interests if possible, and written acknowledgement of the disclosure received.

The burden of proof regarding "adequate financial disclosure" is on the person denying having adequate knowledge.

19. Gift Effects of Structuring and Restructuring Interests in Trusts; Enhancing Traditional Planning To Avoid Necessity of Later Modification Transactions, Given Their Resulting Gift Uncertainties

Comments in this item are from an excellent presentation by Diana Zeydel and a panel discussion by Diana Zeydel, Todd Angkatavanich, and Jonathan Blattmachr, at the 60th Heckerling Institute on Estate Planning.

If long-duration trusts remain the norm, the demand for modifying them after creation will only grow. As a result, evaluating any modification to (or any transfer of an interest in) an irrevocable trust requires understanding what is permitted under applicable law and the tax consequences of making or facilitating those changes.

Because of the potential gift tax effects of exercising state law remedies to make modifications of trust interests (such as trust modification, decanting, merger, etc.), planning alternatives are discussed to enhance trust techniques that we have been using for decades (such as QPRTs, GRATs, CLATs, and QTIPs) and yet have potential shortcomings.

a. **Overview of Determining When Gifts Occur as a Result of Actions with Trust Interests.** The first step in the analysis is to define the transferred property and how its value will be measured. The foundational rule is that state law determines the nature of property interests, while federal law determines tax treatment. *Knight v. Commissioner*, 115 T.C. 506 (2000). Under §2511, the gift tax can apply to transfers made directly or indirectly. Even contingent or discretionary interests—which may not be readily transferable under state law—can still present gift tax risk if a beneficiary relinquishes rights or if a change enhances the value of another's interest in the trust. Actions that appear to be "non-transfer" in substance, such as relinquishing rights or consenting to trustee changes, may still shift value and trigger transfer tax consequences. Courts have even treated certain failures to enforce rights, such as allowing claims to lapse, as gratuitous transfers. *See* Rev. Rul. 81-264, 1981-2 C.B. 185.

b. **Exercise of Inter Vivos Limited Power of Appointment.** As an example of a situation where a state law alternative for changing a trust interest exists but can result in federal tax consequences, assume a large irrevocable trust requires all income to be distributed to A, and A also has a lifetime power of appointment in favor of her descendants, which include B and C. A has no need for the assets in the trust and desires to send assets to B and C, who need resources. A exercises her power of appointment in favor of B and C. Rev. Rul. 79-327 says that A has made a gift under §2511 of her income interest in the underlying relinquished property (the mandatory income interest), which is capable of being valued. If the trust agreement instead did not require income distributions to A but allowed the trustee to make distributions in the trustee's discretion, PLR 200243026 says that A has still made a taxable gift. However, a discretionary interest such as this one is much more difficult to value; there is very limited guidance on how to determine the value of transfers of discretionary interests in trusts.

c. **Other Actions Involving Trust Interests That May Result in Gifts, Including Failure To Object.** Other examples of state law remedies that may be helpful for changing trust interests but may result in federal tax consequences include rescission, reformation, modification, termination, and decanting. In CCA 202352018, the Service concluded that the state law modification of a trust with consent of the beneficiaries to add a tax reimbursement clause in favor of the grantor resulted in a taxable gift by the beneficiaries. The Service also noted that had the beneficiaries not been required to consent but were provided with a right to object to the modification and thereafter failed to do so, the gift tax result would have been the same. See Item 28.h(1) below. *See also* Rev. Rul. 81-264 (gift can occur by permitting legal rights to expire, but a transfer that one may rescind under state law might remain incomplete until the right to rescind expires); Letter Ruling 201122007 (trustee advanced principal to remainder beneficiaries from a trust having the taxpayer as the only current beneficiary for her "health, support, or maintenance" and the beneficiary's resources were such that she did not anticipate receiving any distributions; ruling that there was no loss of GST exempt status, but a

taxable gift resulted from the relinquishment of her discretionary interest even though the value may be nominal).

The pending *McDougall* decision will address the effects of a testamentary limited power of appointment and other discretionary decisions that could impact the valuation of a remainder interest given by remainder beneficiaries to the current beneficiary when they agreed to an early termination of the trust. See Item 28 below.

Some cases have refused to allow retroactive tax consequences by amendment and reformations in a nonadversarial proceeding. *E.g.*, *Van Den Wymelenberg v. United States*, 397 F.2d 443 (7th Cir. 1968). However, various cases have held that no taxable gifts resulted from state law rescissions, transfers to trusts based on a mistake of law, or unintended tax consequences. *Dodge v. United States*, 413 F. 2d 1239 (5th Cir. 1969) (transfer incomplete; donor had not given up dominion and control of transferred property because of state law remedy to undo the mistake); *Neal v. United States*, 83 AFTR 2d 99-2325 (3rd Cir. 187 F.3d 626) (gift tax refunded when donor rescinded transfer under a mistake of law due to being mistaken as to the effect the law would have on her tax liabilities when she released such interest). A footnote in the written materials cites a number of similar rescission/reformation cases.

> See Breakiron v. Gudonis, No. 09-10427-RWZ, 2010 WL 3191794 (D. Mass. Aug. 10, 2010) (permitting the rescission of tax defective disclaimer of remainder interest in QPRT to avoid a $2.3 million gift tax liability); Kaufman v. Richmond, 811 N.E. 2d 987 (Mass. 2004) (disclaimer of inherited property reformed so that it would not exceed decedent's remaining GST exemption); DiCarlo v. Mazzarella, 717 N.E. 2d 257 (Mass. 1999) (allowing reformation of scrivener's error when "clear and decisive proof" showed settlor intended to qualify for federal estate tax marital deduction); see also Neal v. United States, 83 A.F.T.R. 2d 99-2325, 99 -2327 (3rd Cir. 1999) (holding that rescission for mistake of law eliminated gift tax liability); First Security Bank v. United States, No. CIV. 99-1298, MV/DJS (D.N.M. Apr. 30, 2001) (holding that transfer in trust for husband was incomplete and therefore voidable under New Mexico law because it was implicitly conditioned upon a timely execution of a QTIP marital deduction election), reversed sub nom. Wells Fargo Bank N.M., N.A. v. United States, 319 F. 3d 1222 (10th Cir. 2003); Griffin v. Griffin, 832 P. 2d 810 (Okla. 1992) (holding that evidence of mistake [was] clear and tax objectives can be considered in determining intent and reforming trust to delete language objectionable for marital deduction purposes).

d. ***Bosch*; Pre-Transaction Construction Actions, Rev. Rul. 73-142.** In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), which involved a state court construction of actions that purportedly allowed a transfer to a trust to qualify for the estate tax marital deduction, the Supreme Court ruled that state court decisions should not be binding on the IRS in tax cases, and that federal courts in tax cases will be bound only by the state's highest court in the matter before it. That same approach was extended to settlements in *Ahmanson Foundation v. United States*, 674 F.2d 761 (9th Cir. 1981). In Rev. Rul. 73-142, the IRS pointed out that pre-transaction construction actions (rather than rescission, reformation, modification, or construction proceedings after transactions have taken place that could have tax consequences) can avoid the *Bosch* analysis, and that the IRS will be bound by the state court action "regardless of how erroneous the court's application of the state law may have been."

e. **Tax Consequences of Trust Modifications.** For more detailed discussions of the tax effects of trust modification or construction actions, see Items 10, 14-15 of Estate Planning Current Developments and Hot Topics (Dec. 2020) found **here** and Items 42-51 of 2015 ACTEC Annual Meeting Musings (Apr. 6, 2015) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

f. **Qualified Personal Residence Trusts**. QPRTs can be a valuable tool for a grantor to transfer a home to an irrevocable trust while retaining the right to live there for a set term, ultimately sending the home to the grantor's beneficiaries at a reduced gift tax cost. However, QPRTs are subject to estate tax inclusion under §2036 if the grantor fails to survive the QPRT term. In addition, the grantor will also make a meaningful taxable gift when setting up a QPRT as it is not possible to "zero-out" a QPRT as we can with GRATs and CLATs. How can we avoid these QPRT shortcomings?

With a Split Purchase QPRT, the taxpayers contribute funds to a trust that is fundamentally structured as a traditional QPRT. The parent contributes funds in exchange for a life term interest, and the chcild contributes funds in exchange for the remainder interest. The result is that the parent has not made a taxable gift to the child upon creation of the QPRT, and the residence should not be

included in the parent's taxable estate if he dies before the QPRT term ends. *See* PLRs 200728018, 200112023, 9841017.

g. **Grantor Retained Annuity Trusts**. GRATs are highly effective tools that enable taxpayers to transfer the future appreciation of a gifted asset to the next generation in a manner that is efficient for gift tax purposes (often free from gift tax when structured as a zeroed-out GRAT). However, GRATs also have their shortcomings. If the grantor dies before the GRAT term ends, the assets will be pulled back into the grantor's estate. Also, due to the ETIP rule under §2642(f), GST exemption cannot be allocated to the GRAT until the termination of the annuity term. Due to this restriction, most consider it impossible to leverage the grantor's GST exemption against future appreciation with GRATs, because the first time the grantor can allocate GST exemption is at the end of the term when the appreciation has already occurred. What techniques can be utilized to avoid at least one of these GRAT shortcomings?

(2) **Split Purchase GRAT.** The Split Purchase GRAT is structured like the Split Purchase QPRT. The trust is fundamentally structured as a GRAT. One taxpayer contributes funds in exchange for the annuity, and the other contributes funds in exchange for the remainder interest. When the purchaser of the annuity dies, nothing should be included in his or her taxable estate. The Split Purchase GRAT could permit the allocation of GST exemption to the remainder interest if a GST exempt trust is the purchaser of the remainder interest. See PLR 200728018 (Split Purchase QPRT; reasoning could apply by analogy to Split Purchase GRAT).

(2) **Sale of GRAT Remainder Interest.** This technique involves the creation of a traditional GRAT with a GST nonexempt trust as the remainder beneficiary. After the GRAT is created, the GST nonexempt trust sells its remainder interest in the GRAT to a GST exempt trust for fair market value. The seller GST nonexempt trust would receive cash, other assets, or a promissory note equal to fair market value. However, the remainder interest of the GRAT, and any appreciation, would be held by the GST exempt trust.

The remainder interest should not be deemed an addition to the GST exempt trust from the GST nonexempt trust but instead an investment, as it was purchased for fair market value. However, it is possible that the Service may argue that the payment to the GST exempt trust at the end of the annuity term would constitute an addition to the GST exempt trust, resulting in a partial inclusion ratio.

(3) **Preferred Partnership GRAT.** Before turning to any preferred partnership technique, ask whether a sale could achieve the goal. A sale will always be more efficient due to the ability to use a lower interest rate, and preferred partnerships have much more cost, uncertainty, and complications.

For a detailed discussion of preferred partnership GRATs, see N. Todd Angkatavanich & Karen E. Yates, *The Preferred Partnership GRAT: A Way Around the ETIP Issue?*, 35 ACTEC J. 290 (2009). For a general discussion of planning with preferred partnership interests, see Angkatavanich, *Warming Up To Preferred Partnership Freezes: Multiple Planning Applications with This Versatile Vehicle*, 51st ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING (2017) and Item 17 of LOOKING AHEAD – Estate Planning in 2024 & Current Developments (Including Observations from Heckerling 2024) (Apr. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**

(4) **Remainder Purchase Marital Trust.** The remainder purchase marital trust is a way to achieve many of the advantages of GRATs but without the actuarial risk of the donor dying before the end of the GRAT term or the ETIP limitation that applies to GRATs. *See* Handler & Dunn, *GRATs and RPM Annuity Trusts: A Comparison*, 20 TAX MNGMNT. EST., GIFTS & TR. J. (July 8, 2004); Handler & Dunn, *RPM Trusts: Turning the Tables on Chapter 14*, TRUSTS & ESTATES 31 (July 2000).

h. **Charitable Lead Annuity Trusts**. CLATs allow taxpayers to pay a fixed annuity to charity for a set term, then pass remaining assets to family (or other beneficiaries), potentially reducing gift/estate tax on the transfer while leveraging asset growth. As with GRATs, CLATs are not efficient from a GST tax perspective because §2642(e) provides a special rule for CLATs that delays the determination of a CLAT's inclusion ratio until the termination of the annuity term, prohibiting the ability to leverage the

appreciation of the assets for GST purposes. Similar to GRATs, a CLAT's remainder interest typically passes to GST nonexempt trusts for the benefit of children at the end of the annuity term.

Also similar to GRATs, a planning technique that can possibly improve GST planning with CLATs is the Preferred Partnership CLAT. Instead of the taxpayer transferring the preferred interests to a GRAT and personally retaining the annuity, the taxpayer will transfer the preferred interests to a CLAT with annuity payments going to charity. The common growth interest in the preferred partnership will ideally be held by a GST exempt trust, effectively shifting the appreciation to a vehicle that is exempt from the GST tax and allowing the CLAT technique to leverage appreciation for GST purposes.

i. **QTIP Trusts**. QTIP trusts allow surviving spouses to receive income (and often principal) for life while the grantor controls who ultimately inherits the remaining assets, and it qualifies the transfer for the federal estate tax unlimited marital deduction, deferring estate tax until the surviving spouse's death. However, QTIP trusts are inefficient at shielding the appreciation of the assets donated to the QTIP trust from eventual estate tax; all assets in the QTIP trust are includible in the surviving spouse's estate under §2044, subjecting all assets and appreciation to estate tax.

   Similar to GRATs and CLATs, this shortcoming of QTIP trusts can be mitigated by pairing the QTIP trust with a preferred partnership. The preferred interest would be held by the QTIP trust, limiting the trust's interest to the preferred coupon amount (which would be distributed as mandatory income from the QTIP trust to the surviving spouse) plus its liquidation interest. The common interest in the partnership would be held by the children of the grantor of the QTIP trust, or preferably a GST exempt trust for their benefit, resulting in all future appreciation being held by more tax-efficient owners. This limits the amount included in the surviving spouse's estate under §2044 to the frozen value of the preferred partnership interest.

   Planners must consider whether a contribution of QTIP assets to a preferred partnership triggers §2519. FSA 199920016 and *Kite v. Commissioner,* T.C. Memo. 2013-43, both suggest that §2519 would not apply.

20. Musings About Artificial Intelligence Issues for Estate Planners

Comments in this item are from a panel discussion about artificial intelligence (AI), including ethical obligations, by Jeff Chadwick, Tracy Potts, and Elizabeth Vandesteeg, at the 60th Heckerling Institute on Estate Planning.

a. **Practical Impact on Estate Planning Professionals.** "I'm not worried about AI taking my job, but I am worried about someone who knows how to use AI to do things more productively taking my job." - Jeff Chadwick.

   Generative AI systems can be used for legal and tax research, but ABA Formal Opinion 512 states that attorneys *must* validate and check any output from a generative AI tool; it cites a Stanford study finding that even legal generative AI tools embedded in Thomson Reuters or LexisNexis hallucinated up to 17% of the time (though LexisNexis disputes those findings), **Legal GenAI tools mislead 17% of time: Stanford study | Legal Dive**.

   A practical use of generative AI is to write the first draft of difficult emails, letters, messages, etc. The planner may procrastinate writing the difficult message, struggling over "just the right words," and getting a first draft is a huge help.

   Giving good "prompts" is essential to getting a good product. Detailed prompts can be *spoken*, describing in the detail the context, the purpose and audience of the message, the type of message desired, the various points to be made in the message, and the tone, format, length, etc. The more detail and direction that is given, the better the output will be.

b. **Some Generative AI Platforms.** Generative AI is a type of artificial intelligence that creates new, original content. Rather than merely analyzing or classifying existing data, generative AI uses models like transformers and neural networks to produce, on demand, novel, human-like outputs based on user prompts.

   The most popular generative AI platforms are ChatGPT (60.3%), Co-Pilot (14.3%), and Gemini (13.5%). Others are Perplexity, Claude Opus (which many clients like), Grok, DeepSeek, Brave Leo

AI, Komo, and Andi. New models in 2025 included Sonnet (May), Grok4 (Jul.), ChatGPT 5.0 (Aug.), Claude Opus 4.1 (Aug.), DeepSeek 3.1 (Aug.), C-Pilot (Aug.), and Gemini 3 (fall). Users should be aware that DeepSeek is monitored by the Chinese government.

When DeepSeek was released by a Chinese firm in January 2025, it was considered so revolutionary that the U.S. eliminated all guardrails from the development of new AI, but experts later discovered that it used stolen ChatGPT code and used GPT chips. But it does use less resources, uses fewer Nvidia chips, and runs faster; its development has been a Sputnik moment in the world of AI.

Generative AI tools used frequently by panelists include Co-Pilot, CoCounsel, and DeepResearch Westlaw.

c. **Enterprise Platforms; Privilege Concerns.** Some of the AI platforms have developed "Enterprise" systems (e.g., ChatGPT Enterprise) that do not share information publicly. Users should not upload any client information to a generative AI system that is not a private "enterprise" system.

The attorney-client privilege "protects communications (1) between a client and his or her attorney (2) that are intended to be, and in fact were, kept confidential (3) for the purpose of obtaining or providing legal advice." *United States v. Mejia*, 655 F.3d 126, 132 (2d Cir. 2011).

A federal district court has ruled that documents generated on a public AI platform were not protected by attorney-client privilege or the attorney work product doctrine. *United States of America v. Heppner*, 25-cr-00503-JSR, (S.D.N.Y. Feb.10, 2026) (granting government's motion to access documents). In that criminal case, federal agents seized computers containing documents the defendant had generated by submitting queries (using information that had been supplied in part by his attorney) into Claude. The government argued that the documents were not protected by attorney-client privilege because (1) they were not communications between the defendant and his counsel, (2) they were not created for the purpose of obtaining legal advice from counsel (AI is not a lawyer and Claude's terms of service agreement said it does not provide legal advice), (3) they were not confidential because Claude's terms of service agreement allows data retention to train its AI tool and sharing information with governmental authorities and third parties, and (4) giving the documents to his attorney did not retroactively create privilege. The government also argued that the documents were not shielded by the work product doctrine because they were not created at the counsel's direction. AI tools are not attorneys and cannot confer the legal privileges of working with one.

d. **Transcription; Automatic Notetaker Systems.** Fireflies.ai is a free AI notetaker program that is popular. (It is generally considered safe, with robust security features.) The planner should be careful to consider who has access to the transcription files. Generally, the planner would prefer a service selected by the planner, which will be vetted to make sure it is secure, rather than using a transcription service selected by the client. (If it is not secure, attorney-client privilege may be waived as to discussions during the meeting.).

e. **Mobile Phones Are Listening.** Most mobile phones have an AI overlay that may be listening, depending on the phone's privacy settings, even when the phone is turned off. There have been examples of situations where, for example, funeral issues were discussed in a meeting and the client received multiple ads the following day about funeral services.

f. **Ethics Issues.** ABA Formal Opinion 512 is the first ABA opinion addressing the ethical considerations for the use of generative AI (GAI) tools in law practice. It states that attorneys must have "… a reasonable understanding of the capabilities and limitations of the specific GAI technology that the lawyer might use …" It addresses a variety of ethical issues, including whether lawyers must disclose their use of a GAI tool to a client and how such GAI tool impacts the reasonableness of the lawyer's fee. Various ethics rules impacted by the use of generative AI include Model Rules 1.1, (competence), 1.4 (communications with clients), 1.6 (confidentiality of information), 1.15 (safekeeping property), 5.1 (responsibilities of supervising attorneys), and 5.3 (responsibilities regarding nonlawyer assistance).

Obtaining informed consent to disclose client information in unrestricted public GAI tools may not be practically possible. Informed consent would include providing information explaining the extent and risks of using the model, the ways that others might use the information from the model, clear

explanation of the specific GAI tool that is used, etc. Including a boilerplate waiver in the client engagement letter would not be sufficient to represent informed consent.

g. **Common Client Concerns and Questions.** Common client concerns, for which the planner should have a response, include: (1) "why can't I just prepare my documents using AI instead of you?," (2) explaining why the planner is still needed and why AI does not replace the planner, (3) whether using AI reduces the bill, (4) "why didn't using AI reduce the bill, or if AI was not used, why didn't you use AI to reduce the bill?," (5) how the AI platform accesses the client's information, and (6) a general understandable explanation of how the planner's use of AI affects clients.

b. **Rapid Very Powerful AI Changes Coming (And Are Here!).** Matt Shumer wrote an article in February 2025 that created a big buzz (and scare) about the power of AI. Each newer version of AI is dramatically better and faster than the last. Matt is a developer of apps, and he says that AI now creates all the coding that he previously labored over to develop apps. One managing partner of a large law firm says that using AI is "like having a team of associates available instantly." The following are a few excerpts from his eye-opening article.

> For years, AI had been improving steadily. Big jumps here and there, but each big jump was spaced out enough that you could absorb them as they came. Then in 2025, new techniques for building these models unlocked a much faster pace of progress. And then it got even faster. And then faster again. Each new model wasn't just better than the last... it was better by a wider margin, and the time between new model releases was shorter. I was using AI more and more, going back and forth with it less and less, watching it handle things I used to think required my expertise.
>
> Then, on February 5th, two major AI labs released new models on the same day: GPT-5.3 Codex from OpenAI, and Opus 4.6 from Anthropic (the makers of Claude, one of the main competitors to ChatGPT). And something clicked. Not like a light switch... more like the moment you realize the water has been rising around you and is now at your chest.
>
> **I am no longer needed for the actual technical work of my job.** I describe what I want built, in plain English, and it just... appears. Not a rough draft I need to fix. The finished thing. I tell the AI what I want, walk away from my computer for four hours, and come back to find the work done. Done well, done better than I would have done it myself, with no corrections needed. A couple of months ago, I was going back and forth with the AI, guiding it, making edits. Now I just describe the outcome and leave.
>
> Let me give you an example so you can understand what this actually looks like in practice. I'll tell the AI: "I want to build this app. Here's what it should do, here's roughly what it should look like. Figure out the user flow, the design, all of it." And it does. It writes tens of thousands of lines of code. Then, and this is the part that would have been unthinkable a year ago, it **opens the app itself**. It clicks through the buttons. It tests the features. It uses the app the way a person would. If it doesn't like how something looks or feels, it goes back and changes it, on its own. It iterates, like a developer would, fixing and refining until it's satisfied. Only once it has decided the app meets its own standards does it come back to me and say: "It's ready for you to test." And when I test it, it's usually perfect.
>
> …
>
> The models available today are unrecognizable from what existed even six months ago….
>
> Part of the problem is that most people are using the free version of AI tools. The free version is over a year behind what paying users have access to….
>
> … [One partner at a law firm], the managing partner at a large firm, spends hours every day using AI. He told me it's like having a team of associates available instantly….
>
> …
>
> **This might be the most important year of your career. Work accordingly.** I don't say that to stress you out. I say it because right now, there is a brief window where most people at most companies are still ignoring this. The person who walks into a meeting and says "I used AI to do this analysis in an hour instead of three days" is going to be the most valuable person in the room. Not eventually. Right now. Learn these tools. Get proficient. Demonstrate what's possible. If you're early enough, this is how you move up: by being the person who understands what's coming and can show others how to navigate it. That window won't stay open long. Once everyone figures it out, the advantage disappears.
>
> **…**

> Here's a simple commitment that will put you ahead of almost everyone: spend one hour a day experimenting with AI. Not passively reading about it. Using it. Every day, try to get it to do something new... something you haven't tried before, something you're not sure it can handle.
>
> …

Blog by Matt Schumer, *Something Big is Happening* (Feb. 9, 2026) (emphasis in original), ttps://shumer.dev/something-big-is-happening.

21. Aging and Disability Planning – Cracks in the Safety Net

Comments in this item are from an excellent presentation by Tara Pleat at the 60th Heckerling Institute on Estate Planning.

a. **Staggering Statistics.**

(1) **Aging Demographics.**

- 57 million Americans are age 65 and older (17% of population); 25% of these are expected to reach age 90, and 10% will reach age 95.
- 6 million Americans have Alzheimer's disease; that number is projected to be 18 million by 2050.

(2) **Disabilities.**

- 60 million Americans live with a disability (18% of the population).
- Life expectancy of individuals with disabilities is increasing.
- At the end of 2023, almost 500,000 individuals were on state home and community-based services waiting lists (and waitlists are not maintained in many places).

(3) **Caregiving and Care Industry Workforce.**

- The U.S. birth rate has fallen 20% since 2007; this leads to a smaller work force and fewer family caregivers.
- There was a 45% increase in the number of Americans providing ongoing care to adults or disabled children between 2015-2025, and 20% of individuals age 45-54 and 21% of individuals age 55-64 are providing that care.
- 57% of caregivers were parents of children living at home and providing care for their parents (the "sandwich generation").
- In the care industry, 37% of direct care workers (DCWs) live in or near poverty and 49% rely on public assistance programs to make ends meet.
- Stagnant Medicaid reimbursement rates incentivize qualified workers to seek out the private sector; for example, New York reimbursement rates have not increased since 2007. Care industry direct care workers have a median wage of $16.72 per hour, close to the poverty level; they can make more at McDonalds or an Amazon distribution facility.
- There will be 9.3 million direct care job openings between 2021-2031.
- 62% of service providers have stopped accepting new referrals of people with disabilities and 52% of service providers are discontinuing existing programs due to insufficient staffing.

(4) **Impact of These Statistics.** Small workforce + aging population + increasing disability population will put substantial pressure on social insurance programs like Social Security, Medicare, and Medicaid (funded by taxes but the tax base is shrinking) and the ability of caregivers and the care industry to provide needed care.

b. **Public Providers Cannot Provided Needed Services.** Planners must tell clients the truth—they cannot rely on the public providers system, which is woefully underfunded. Public services are

designed to provide baseline support and emergency intervention; they do not provide the continuity and quality of care that family members provide. Private funding once supplemented public programs, but because of the low level of private funding, the public system will need to support private dollars due to scarcity.

c. **Planning Considerations for Caregivers Who Are Concerned About Who Provides Care When They Can No Longer Do So.**

(1) **Test Out Community Services**. See what care can be provided currently by available community services. Identify tasks that can be transitioned.

(2) **Family Caregivers**. Realistically consider what other family members could/would provide care without overcommitment. Who is on the bench? Does the caregiver want to stick family members with that responsibility?

(3) **Explore Available Services.** Explore the availability of Medicaid-funded services, including services of Medicaid-funded Care Managers or Service Coordinators. Explore private services and housing and care options. Consider what geriatric care manager services are available.

(4) **Letter of Intent or Lifecare Plan.** The client should draft a detailed letter describing all the services the client provides each day, week, and year so someone else can step in to provide support. Include food preferences and other lifestyle preferences.

(5) **Educating Successors and Advocates for Transition.** Educate other family members that may be able to provide caregiving services or who will be advocates for the individual. Meet with them to review lifecare plans, and encourage them to visit the individual's residence and meet the staff.

d. **Estate and Financial Planning.** Consider a third-party supplemental (special) needs trust to provide private funding, ABLE accounts, and 529 plans. (Trusts for the beneficiary without special needs provisions could prevent the beneficiary from qualifying for Medicaid programs.) Prepare documentation for legal authority to act on behalf of the individual (guardianship, agency, power of attorney, planned directives, etc.). Most important is to understand that private funding will be needed as a practical matter to provide the needed support once the client can no longer be the caregiver; Medicaid cannot cover everything.

22. Trusts – Eroding the "Irreducible Core"

Comments in this item are observations from an excellent presentation by Phil Hayes, and a panel discussion by Phil Hayes, Carol Harrington, Lauren Hunt, and Stefanie Lipson, at the 60th Heckerling Institute on Estate Planning.

a. **"Irreducible Core."** An English case captivates the concept of the "irreducible core" of a trust: "There is an irreducible core of obligations owed by the trustee to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. *If the beneficiaries have no rights enforceable against the trustee there are no trusts*." *Armitage v. Nurse,* [1997] EWCA Civ 1279, [1998] Ch. 241 (Eng.) (emphasis added).

A 2002 Delaware case refers to the fundamental essentials to have a trust: "A trust in which there is no legally binding obligation on a trustee is a trust in name only and more in the nature of an absolute estate or fee simple grant of property" to the trustee. *McNeil v McNeil,* 798 A.2d 503, 509 (Del. 2002).

Justice Cardozo famously declared that "[a] trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive…" *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (N.Y. 1928).

b. **Race of States To Attract Trust Business in a Way that Erodes the Irreducible Core.** Following the adoption of the generation-skipping transfer tax in 1986, and the movement by a few states to eliminate the perpetuities limitations on trusts, some states have proceeded to outdo themselves to allow maximum freedom to settlors, to the point of allowing the erosion of the fundamental essential characteristics of a trust. These trends include eliminating limitations on perpetuities, exculpation of

trustees, eliminating the requirement to provide information to trust beneficiaries ("silent trust" provisions), directed trusts, decanting, and expanded ability to modify trusts.

As an example of a provision that could erode fundamental trust characteristics, Delaware and South Dakota statutes permit the governing instrument to "expand, restrict, eliminate, or otherwise vary" any provisions of general application to trusts, with a few limitations. Delaware does not permit exculpation or prohibit removal of a fiduciary for "wilful misconduct," and South Dakota places limits on a corporate trustee's depositing funds with itself and does not permit exculpation for bad faith or gross negligence.

Some directed trust statutes allow appointing an advisor or director who does not act as a fiduciary, and the trustee has no liability for following the directions of that advisor or director (or perhaps is liable only for the trustee's "wilful misconduct" in following those directions). In Wyoming, the "excluded fiduciary" of a directed trust has no duty to review the acts of the advisor and is not liable for any loss resulting from action/inaction of the advisor. In South Dakota, the excluded fiduciary is not liable for any loss from complying with directions from a trust advisor, including if the advisor is breaching fiduciary responsibilities or *even if the advisor is acting beyond the scope of the advisor's direction authority*.

c. **Uniform Trust Code Default and Mandatory Provisions Approach.** The Uniform Trust Code (UTC) states that the duty of a trustee to administer the trust in good faith and in accordance with the terms and purposes of the trust *and the interests of the beneficiaries* cannot to be overridden by the trust instrument. UTC §105(b)(2). A comment adds: "A settlor may not so negate the responsibilities of a trustee that the trustee would no longer be acting in a fiduciary capacity." Section 105 of the UTC provides that the terms of a trust prevail over any provision of the Code except for a list of 14 things that are mandatory and cannot be overridden. (Two obligations of trustees to provide information to beneficiaries among those 14 items are listed in brackets, inviting states to exclude them as they adopt the UTC, which some states have done.)

d. **Decanting.** Some states allow decanting to a trust with substantial changes in trust provisions, including elimination of mandatory distribution or withdrawal rights, adding or removing beneficiaries, changing the standard for discretionary distributions, and granting a general power of appointment to a beneficiary of the decanted trust. If the governing law of the trust does not permit those substantial changes, the trustee might be able to decant the trust to a trust with a trustee in another state that does allow those changes, and the decanting would be a matter of administration governed by the law of the place of administration. See Item 14.d(6) above. If the settlor does not want to permit that broad of a change to the trust by decanting, consider adopting decanting restrictions in the trust agreement in lieu of relying on a statute and providing that the governing law for decanting cannot change by changing the place of administration.

e. **Recognition of Trust for Income Tax Purposes?** Reg. § 301.7701-4(a) defines a trust as an arrangement "whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts." If a trust arrangement has pretty much all of the fiduciary protection afforded beneficiaries stripped away from the trust, will it be recognized as a trust for income tax purposes or will it be treated as an association?

23. Charitable Remainder Trust (CRT) Drafting; Provisions Not Included in IRS Forms

Comments in this item are from an excellent presentation by Kelly Hellmuth at the 60th Heckerling Institute on Estate Planning. Revenue Procedures 2003-53 to -60 provide eight sample CRAT forms and Revenue Procedures 2005-52 to -59 provide eight sample CRUT forms. Some of the provisions that planners might consider adding to a CRT form are highlighted.

a. **Term of Trust.** A CRT may last "for a term of years (not in excess of 20 years) or for the life or lives of [the income beneficiaries]." The forms are divided based on the term of the trust (term of years, one life, or two lives) and how many recipients are included. There is no guidance regarding the ability or inability to combine different types of trust terms. The key is that a term of years cannot be

added at the end of a life term, and a life term can be added at the end of a term of years only if the measuring life person is living when the CRT is created.

b. **Spousal Waiver of Right of Election.** Assets in a CRT might be included in the donor-beneficiary's augmented estate and perhaps could be reached to satisfy the elective share. That would invalidate the CRT because under the CRT rules no payment may be made to anyone other than the income beneficiary or the charitable remainder beneficiary. Pursuant to Notice 2006-15, the IRS will disregard the spousal right to election, even without a waiver, as long as the surviving spouse did not exercise the right of election. Even so, the safer route is to include a spousal waiver whenever a new CRT is created or new assets are added to a CRT.

c. **Tax Apportionment.** A qualified CRT is not permitted to pay a decedent's transfer taxes, administrative expenses of the decedent's estate, or debts of the decedent. A savings provision regarding the apportionment of federal or state death taxes from the trust is included in the inter vivos two lives forms. A similar savings provision should be included in other CRTs as well.

d. **Valuation of Unmarketable Assets.** The valuation of unmarketable assets must be performed exclusively by an independent trustee or by a current qualified appraisal. CRUT forms include provisions regarding the valuation of unmarketable assets. Those provisions should be revised to refer to Reg. §1.170A-17(a) and §1.170A-17(b), respectively, for appraisals prepared for returns or submissions for donations made on or after January 1, 2019. In addition, similar valuation provisions should be added to CRAT forms as well.

e. **Private Foundation Rules.** CRTs are subject to the self-dealing and taxable expenditures rules but not the other private foundation rules. The sample forms include appropriate restrictions, and no further private foundation restrictions need to be added. Indeed, providing that CRTs are subject to the other private foundation rules could be confusing (for example, requiring that minimum charitable distributions be made from the trust in each year). If the trust continues in existence at the end of the stated term solely for the charity's benefit, the private foundation rules should be added to the trust as of the time it becomes a wholly charitable trust.

f. **Savings Clauses.** The forms have good savings clauses allowing the trustee to amend the trust for the sole purpose of ensuring that it qualifies as a CRT. The CRAT forms also include language to ensure the CRAT will not fail to be qualified because of the 5% probability of exhaustion test. That language should be adjusted for testamentary CRTs, where the exact calculation of the 10% test (and 5% exhaustion test, if applicable) cannot be performed until the §7520 rate is known at the time of death.

g. **Minor or Incompetent Beneficiary.** If the individual beneficiary is a minor or may become incompetent, the sample form does not explicitly permit distributions to a trust for that individual. Rev. Rul. 2002-20 allows distributions to a trust in such circumstances but only if certain conditions are satisfied. A provision could be added allowing a distribution to a trust for such a beneficiary, following the guidelines of Rev. Rul. 2002-20.

h. **Spendthrift Clause.** The IRS sample forms do not include a spendthrift provision. A spendthrift clause could be added but doing so may be inadvisable in some circumstances. Several reasons for not having a spendthrift clause are (1) the income beneficiary may need funds and want to sell the income interest to the charitable remainder beneficiary, (2) the income beneficiary may no longer need distributions from the CRT and wish to donate the income interest to the charity, or (3) the income beneficiary and charitable remainder beneficiary may decide to terminate the trust early by a commutation paying each its actuarial interest in the trust.

i. **Grantor Trust.** The CRT cannot be a grantor trust (it would no longer be a tax-exempt trust). Be very careful to avoid any powers or interests causing the trust to be a grantor trust, and consider adding a savings clause to prohibit any actions that would cause the trust to be a grantor trust.

24. Musings about Creditor Protection Planning (Including Issues for SLATs)

Comments in this item are from a panel discussion by Gideon Rothschild, Judge Mindy A. Mora (U.S. Bankruptcy Court, Southern District of Florida) and Barry Nelson, at the 60th Heckerling Institute on Estate Planning. (Lists of state statutes in this item come from their excellent materials.)

a. **Degree of Control; LLCs.** The extent of the debtor's control over assets is very important in determining if the assets are subject to the debtor's creditors. One of the "badges of fraud" to determine if a transfer is a fraudulent transfer (or a voidable transfer) is whether the debtor has control over the assets. The less control the better. For example, the ability to remove and replace a trustee or to direct when distributions are made (such as being the distribution adviser of a directed trust) would be very significant. Judge Mora's overarching observation: "It comes down to control. If the client wants to keep control, that will be a weak link in the asset protection planning."

An example of debtor-settlor control could be if the operating agreement of an LLC owned by a trust in a state with a domestic asset protection trust (DAPT) statute names the settlor as manager of the LLC. Even though the LLC is owned by a DAPT, LLC assets may be subject to the settlor's creditors if the settlor as manager has any control over payments to the settlor from the LLC, jeopardizing the protection of the DAPT structure.

b. **State DAPT Statutes**. Twenty-one states now have DAPT statutes.

1. Alabama (effective April 18, 2021), ALA. CODE § 19.3E-1
2. Alaska, ALASKA STAT. §§ 13.36.310, 34.40.110
3. Arkansas (effective August 1, 2023), ARKANSAS CODE Title 28, Chapter 72, Subchapter 7
4. Connecticut, P.A. 19-137
5. Delaware, 12 DEL. C. §§ 3570-3576
6. Hawaii, H.R.S. § 554G
7. Indiana, IC 30-4-8-14
8. Michigan, MICH. COMP. LAWS 700.1041 to 700.1050
9. Mississippi, MISS. CODE ANN. §§91-9-701 to 91-9-723
10. Missouri, R.S. MO. Chapter 456
11. Nevada, NEV. REV. STAT. §§166.010 to 166.170
12. New Hampshire, NEW HAMPSHIRE RSA 564-B:5-505A
13. Ohio, Ohio Legacy Trust Act, Chapter 5816 of the OHIO REVISED CODE
14. Oklahoma, Family Wealth Preservation Act, OKLA. STAT. Tit. 31 §§ 10 to 18
15. Rhode Island, R.I. GEN. LAWS §§ 18-9.2-1 to 18.9.2-7
16. South Dakota, S.D. COD. LAWS §§55-16-1 to 55-16-16
17. Tennessee, TENN. CODE ANN. § 35-16-101
18. Utah, UTAH CODE ANN. § 25-6-501, *et seq.*
19. Virginia, VA. CODE §§ 64.2-745.1 and 64.2-745.2 (amended 2012)
20. West Virginia, W. VA. CODE Sections 44D-5-503a, 44D-5-503b, 44D-5-503c, and 44D-5-505
21. Wyoming, Qualified Spendthrift Trust (QST): W.S. §§4-10-502 and 4-10-510 to 4-10-523; Discretionary Asset Protection Trust (Discretionary APT): W.S. §§ 4-10-504 and 4-10-506(c)

Of the statutes listed above, the Oklahoma statute is limited in its scope of protection. The panel's materials state:

> … Oklahoma, pursuant to the Family Wealth Preservation Trust Act of June 9, 2004 (O.S. § 10,Title 31), permits an individual to create a trust with a bank or trust company located in Oklahoma (but not an individual resident of Oklahoma), for the benefit of his or her spouse, descendants and any one or more Internal Revenue Code §

501(c)(3) charities, and to retain the right to revoke the trust, without causing the trust to thereby be available to creditors. In addition, the law provides that no court shall have the authority to compel the settlor to exercise his or her power to revoke the trust. The law does, however, limit the protection to $1 million of transferred assets plus any subsequent appreciation thereon. In addition, the corpus of the trust must consist of assets in Oklahoma based banks, real estate located in Oklahoma, and securities issued by Oklahoma based companies (including corporations, limited liability companies and limited partnerships formed or domesticated in Oklahoma and having a principal place of business in Oklahoma). However, the Oklahoma law does not technically provide for "self-settled" spendthrift trusts because the settlor himself cannot be a beneficiary of such a trust.

In contrast, Alaska, Nevada, Utah, South Dakota, and Delaware are generally regarded as having laws that are the most friendly to debtors among the states with a DAPT statute.

c. **State Statutes Addressing Creditor Concerns If Settlor Becomes Beneficiary of a SLAT or Inter Vivos QTIP Trust.** One of the toughest issues that arises with SLAT planning is the potential creditor issue under the relation-back doctrine. If the donee spouse were to predecease the donor spouse, the donee spouse could have the ability to appoint the assets into a trust of which the original donor spouse is a discretionary beneficiary. Under the traditional "relation-back doctrine," when a power of appointment is exercised it is deemed to be exercised on behalf of the settlor, so the settlor is treated as the settlor of the recipient trust for state property law purposes. Therefore, unless the laws of a DAPT state apply, creditors of the donor could reach the SLAT assets.

At least nineteen states have statutes that address this situation in the context of initial transfers to an inter vivos QTIP trust, as opposed to transfers to a lifetime credit shelter trust. In those states, if assets from an inter vivos QTIP trust remain in trust for or are appointed to a trust for the donor-spouse as a discretionary beneficiary, the donor-spouse's creditors would not be able to reach the trust assets.

1. Arizona, ARIZ. REV. STAT. § 14-10505(E)
2. Arkansas, ARK. CODE ANN. § 28-73-505(c)(1)
3. Delaware, 12 DEL. C. § 3536(c)(4)
4. Florida, FLA. STAT. § 736.0505(3)
5. Georgia, GA. CODE ANN. § 53-12-82(b)
6. Kentucky, KY. REV. STAT. ANN. § 386B.5-020(8)(a)
7. Maryland, MD. CODE ANN., EST. & TRUSTS § 14.5-1003(a)(2)
8. Michigan, MICH. COMP. LAWS § 700.7506(4)(b)
9. Mississippi, MISS. CODE ANN. § 91-8-504(d)
10. New Hampshire, N.H. REV. STAT. § 564-B:5-505A(e)(3)-(4)
11. North Carolina, N.C. GEN. STAT. 36C-5-505
12. Oregon, OR. REV. STAT. § 130.315(4)
13. Ohio, OHIO REVISED CODE § 5805.06(B)(2)(b)
14. South Carolina, S.C. CODE ANN. § 62-7-505(b)(2)
15. Tennessee, TENN. CODE ANN. § 35-15-505(d)
16. Texas, TEX. PROP. CODE ANN. § 112.035(g)
17. Virginia, VA. CODE ANN. § 64.2-747(B)(3)
18. Wisconsin, WISC. STAT. ANN. § 701.0505(2)(e)1.a.
19. Wyoming, WYO. STAT. ANN. § 4-10-506(f)

The non-DAPT states with these statutes regarding inter vivos QTIP trusts include Arizona, Arkansas, Florida, Georgia, Kentucky, Maryland, North Carolina, Oregon, South Carolina, Texas, and Wisconsin.

Statutes in at least eight states, Arizona, Florida, Maryland, Michigan, Mississippi, North Carolina, Ohio, and Texas, also address the issue for all inter vivos trusts initially created for the benefit of the settlor's spouse (including a SLAT) where the assets end up in a trust that benefits the original

settlor-spouse. *E.g.*, ARIZ. REV. STAT. §14-10505(E-F); FLA. STAT. §736.0505 (2022); MD. CODE ANN., EST. & TRUSTS § 14.5-1003(a)(1); MISS. CODE ANN. §91-9-504(d)(2)-(3); N.C. GEN. STAT. §36C-5-505(c)(1)c, OHIO REV. CODE §5805.06(B)(3)(a) (not treated as self-settled if someone can appoint back to settlor); TEX. PROP. CODE §§112.035(d)(2) (settlor becomes beneficiary under exercise of power of appointment by a third party), 112.035(g)(1) (marital trust after death of settlor's spouse), 112.035(g)(2) (any irrevocable trust after death of settlor's spouse), 112.035(g)(3) (reciprocal trusts for spouses).

d. **State Statutes Addressing Creditor Effects of Tax Reimbursement Clauses.** The trust agreement for a grantor trust may authorize the trustee to reimburse the grantor for income taxes the grantor pays with respect to income of the trust. The trust becomes a self-settled trust to that extent, but the trust provisions could be designed to satisfy state DAPT statutes, if applicable. In addition, non-DAPT states with these tax reimbursement protection" statutes include Arizona, Florida, Kentucky, Maryland, New Jersey, North Carolina, Oregon, New York, and Texas. *E.g.*, TEX. PROP. CODE §112.035(d)(1) (a settlor is not considered a beneficiary of a trust solely because a trustee other than the settlor "is authorized under the trust instrument to pay or reimburse the settlor for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by the settlor under the law imposing the tax"); s*ee* Rev. Rul. 2004-64.

The subsequent items discuss various current developments, IRS rulings, and cases. The Appendix includes summaries of select tax provisions in and developmental history of the One Big Beautiful Bill Act (OBBBA).

25. Section 2036 and Valuation Issues for Limited Partnerships (LPs) and Limited Liability Companies (LLCs).

a. **Synopsis of *Estate of Fields*.** Fewer reported cases are addressing the application of §2036 and valuation issues to LPs and LLCs; the most recent was in 2024, *Estate of Fields v. Commissioner*. In that case, the decedent's grand-nephew (N), acting under a power of attorney, for decedent transferred about $17 million of assets (all of the decedent's 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 the "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 after these transfers 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(a)(1) as well as §2036(a)(2). 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.

   The court applied the 20% accuracy-related penalty under §6662(a) and (b)(1) for underpayments attributable to negligence or disregard of rules or regulations.

   Estate of Fields v. Commissioner, T.C. Memo 2024-90 (Sept. 26, 2024, corrected opinion issued Nov. 4, 2024) (J. Copeland).

   For a detailed discussion of *Estate of Fields*, see Item 26 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

b. **Section 2036 Analysis and Planning Implications.** For detailed discussions of planning implications to avoid triggering §2036 for LPs and LLCs, see Item 26(b) of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

For a detailed discussion of the application of §2036 to retained management rights (including when the decedent is the manager of an LLC), including when the decedent owns the majority interest in an entity, see Item 28 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

c. **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 focused on valuing partnership interests. Observe that some cases have allowed discounts even for controlling interests in LPs 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 LP/LLC cases as follows (some additional cases and explanations have been added to the table):

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
Strangi I (2000)	Securities	Tax	31%
Knight (2000)	Securities/real estate	Tax	15%
Jones (2001)	Real estate	Tax	8%; 44%
Dailey (2001)	Securities	Tax	40%
Adams (2001)	Securities/real estate/minerals	Fed. Dist.	54%
Church (2002)	Securities/real estate	Fed. Dist.	63%
McCord (2003)	Securities/real estate	Tax	32%
Lappo (2003)	Securities/real estate	Tax	35.4%
Peracchio (2003)	Securities	Tax	29.5%
Deputy (2003)	Boat company	Tax	30%
Green (2003)	Bank stock	Tax	46%
Thompson (2004)	Publishing company	Tax	40.5%
Kelley (2005)	Cash	Tax	32%
Temple (2006)	Marketable securities	Fed. Dist.	21.25%
Temple (2006)	Ranch	Fed. Dist.	38%
Temple (2006)	Winery	Fed. Dist.	60%
Astleford (2008)	Real estate	Tax	30% (GP); 36% (LP)
Holman (2008)	Dell stock	Tax	22.5%
Keller (2009)	Securities	Fed. Dist.	47.5%

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
Murphy (2009)	Securities/real estate	Fed. Dist.	41%
Pierre II (2010)	Securities	Tax	35.6%
Levy (2010)	Undeveloped real estate	Fed. Dist. (jury)	0 (valued at actual sales proceeds with no discount)
Gallagher (2011)	Publishing company	Tax	47%
Koons (2013)	Securities	Tax	7.5%; Estate owned 70.42% of voting interests and could remove limitation on distributions
Richmond (2014)	Marketable securities	Tax	46.5% (37% LOC/LOM & 15% BIG)
Giustina (2016)	Timberland; forestry	Tax	25% with respect to cash flow valuation (Tax Court applied 75% weight to cash flow factor and 25% weight to asset value method); BUT reversed by 9th Circuit and remanded to reconsider without giving 25% weight to asset value method)
Streightoff (2018)	Securities	Tax	0% lack of control (LOC) discount because the 88.99% LP interest could remove the general partner and terminate the partnership; 18% lack of marketability (LOM) discount
Kress (2019)	Manufacturing	Tax	LOM 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% LOM 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% LOC discount and 30% LOM discount (combined 40.5% discount); transferred limited partner interest in LP valued with 5% LOC discount and 28% LOM discount (combined 31.6% discount)
Warne (2021)	Majority interests in five LLCs (each over 70%) owning real estate	Tax	Four majority LLC interests that did not pass to charity: 2% LOC discount (court might have found no LOC discount but parties agreed some LOC discount was proper) and 5% LOM 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 LOC and LOM discount (court agreeing with view of IRS expert) for transfers of minority nonvoting interests
Pierce (2025)	Online retail	Tax	Taxed as C corporation; gift of 29.4% interest and sale of 20.6 interest; tax affecting recognized; extensive discussion of discount rate for discounting cash flows; 5% LOC discount and 25% LOM discount

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).

26. 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 a grandchild of the settlor (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 early and paying to Grandchild and the Successor Remaindermen the actuarial value of their respective interests. At termination, the trust would be distributed in accordance with each beneficiary's actuarial value of his.her 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 its 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. Some differences include 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. **Potentially 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 questionable 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 these issues, see a summary of the 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); Ed Morrow, *Potential Income Tax Disasters for Early Trust Terminations*, LEIMBERG ESTATE PLANNING NEWSLETTERS #2753 (October 9, 2019); 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).

27. Validity of Regulations, *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (June 28, 2024), *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. 799 (July 1, 2024) and Subsequent Cases, *Bondi v. VanDerStok*, 604 U.S. 458 (March 26, 2025); *Federal Communications Commission v. Consumers' Research*, 606 U.S. 656 (June 27, 2025); *3M Company v. Commissioner*, 154 F.4th 574 (8th Cir. Oct. 1, 2025)

a. **Holding of *Loper Bright*.** In this landmark case, 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). The Court held that the *Chevron* 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. *Loper Bright Enterprises, et al. v. Raimondo, Secretary of Commerce, et al.*, 603 U.S. 369 (June 28, 2024).

The Supreme Court's *Loper Bright* opinion is a massive doctrinal shift that has led to questioning the validity of tax regulations in numerous tax examinations (and starting to appear in reported cases). A somewhat routine argument in many tax cases now involves an argument that some provision of an IRS regulation is invalid under the *Loper Bright* analysis.

b. **Holding of *Corner Post*.** 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).

c. **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 to the regulation in question. 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 the scope of the delegation, and third, the court will determine if the agency has engaged in "reasoned decisionmaking" within the scope of that authorization.

Various courts have rejected attempts to recognize delegated authority from statutory provisions targeted to something else. See *Varian Medical Systems, Inc. v. Commissioner*, 163 T.C. 76, 107-108 (2024) (delegation of authority in §254 did not justify regulation altering §78's effective date); *FedEx Corp. v. United States*, 768 F. Supp. 3d 912, 923-925 (W.D. Tenn. 2025) (government overread §965 as delegating authority for regulatory cutback).

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. However, some Supreme Court Justices have expressed a desire to revisit this doctrine

and make it more restrictive (but the Court did not invalidate an agency action under the nondelegation doctrine in a 2025 case, as discussed in Item 27.d below). The Report suggests that being specific in delegations of rulemaking authority can assist in (i) identifying the specific scope of the authority, (ii) determining whether the agency's response was appropriate, and (iii) satisfying the nondelegation doctrine.

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. The *Loper Bright* opinion 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." However, regulations issued pursuant to a specific grant of authority may continue to be afforded more weight than mere interpretive regulations issued under §7805's general grant of authority.

See Item 31.f(4) below for a brief summary of the IRS's litigating position regarding the extent of statutory authorization under §7805 for upholding a GRAT regulation (in the *Elcan* case). Also see Item 27.d immediately below for a summary of a Supreme Court case addressing rulemaking authorizations similar to §7805.

Relatively few of the Code sections regarding estate and gift taxes include specific statutory authorization for implementing regulations. For a listing of some of the estate and gift tax statues specifically authorizing regulatory guidance, see Item 22.c.4 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

d. **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. 458 (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 affording greater deference 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."

e. **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 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 the Fifth Circuit 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. 656 (June 27, 2025).

f. **First Circuit Level Case To Invalidate a Regulation Using *Loper Bright* Reasoning*, 3M Company v. Commissioner*.** The first federal circuit court of appeals case to use the *Loper Bright* reasoning regarding the validity of a tax regulation is *3M Company v. Commissioner*, 154 F.4th 574 (8th Cir. Oct. 1, 2025), *petition and rehearing en banc and rehearing by the panel denied* (Feb. 19, 2026). The IRS had allocated royalty from a Brazilian affiliate to 3M under §482, even though a foreign law restricted payment of that income. The Tax Court, in a divided opinion, upheld the IRS primarily relying on Reg. §1.482-1(h)(2), known as the blocked income rule. That regulation was issued by the IRS following its losses in several cases holding that for income to be subject to allocation under §482 the taxpayer must have "complete dominion" over the income. The regulation, issued in 1994, reversed the result of those cases. The Supreme Court issued the *Loper Bright* opinion following the Tax Court decision in *3M*. The Eighth Circuit opinion reversed the Tax Court opinion, holding that the IRS cannot reallocate royalties that were not paid due to the Brazilian law restrictions. The Eighth Circuit relied on *Loper Bright* to analyze its construction of §482. The first three words of the opinion are a starkly concise summary of its reasoning: "Statutes trump *regulations."*

Following *3M*, courts may take a much more skeptical view of "fighting regulations" that are promulgated to reverse the effect of court losses by the IRS. To date, such "fighting regulations" had been protected by the Supreme Court in a divided opinion, *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982-83 (2005). *See* Thomas Linguanti & Drew Cummings, *The Eighth Circuit's* 3M *Ruling: An End for* Brand X *and 'Fighting' Regulations?*, 190 TAX NOTES FEDERAL 317 (Jan. 12, 2026). However, the majority opinion in *Lesko v. United States*, 161 F.4th 1352 (Fed. Cir. 2025), seemed "more open to broader delegation of regulatory authority than the Eighth Circuit" in *3m*. Stephen Olsen, *Comparing Circuit Court Review of Regulatory Delegation Under* Lesko *and* 3M, 190 TAX NOTES FEDERAL 2041 (Mar. 23, 2026).

g. **Resources.** 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.** For discussions of the planning implications resulting from *Loper Bright*, including standards for reviewing regulations, increasing attacks on regulations, the Trump administration's review of existing regulations, changing approaches in structuring legislation, and the potential increase of executive branch actions rather than regulatory guidance, see Item 22 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For a discussion of mechanisms for attacking regulation validity, include restrictions under the Anti-Injunction Act, see Item 23 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

28. QTIP Trust Planning; Do Remainder Beneficiaries Make Gifts by Consenting to Spouse Receiving All QTIP Assets?, *Estate of Anenberg v. Commissioner*, 162 T.C. 199 (May 20, 2024); *McDougall v. Commissioner*, 163 T.C. No. 5 (Sept. 17, 2024); CCA 202118008

a. **Brief Synopsis of *Estate of Anenberg v. Commissioner*.** 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 *Estate of Anenberg v. Commissioner*, 162 T.C. No. 9 (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 IRS did not raise the issue of whether the remainder beneficiaries made a gift, and in footnote 18 the court expressed 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*, discussed immediately below.

For a detailed discussion of *Anenberg*, see Item 27 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.**

Estate of Anenberg v. Commissioner, 162 T.C. 199 (May 20, 2024) (Judge Toro, with all judges in agreement).

b. **Brief Synopsis of *McDougall v. Commissioner*.** *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 in his accustomed manner of living. 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. 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 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.

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 [the deceased wife'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 by 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).

c. **Cases Consolidated.** 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.)

d. ***McDougall* Majority Opinion and Concurring Opinion Analysis.** The court's analysis is briefly summarized above in the Brief Synopsis. For a detailed summary of the analysis in the majority and concurring op[inions, see Item 21.c-d of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and 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**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

e. **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 to 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.

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

g. **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 nonjudicial agreement (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 I, LLC v. Commissioner*, 143 T.C. No. 3, at 65 (Aug. 11, 2014)). 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 (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, as 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 by 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. The IRS’s first expert determined the value of each of the Children’s Remainder Interests to be $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 interests’ 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 interests 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 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…."

(3) **Answering Briefs.** Final answering briefs were filed by the IRS (on Oct. 31, 2025) and by the taxpayers (on Nov. 3, 2025). All briefs have been filed, and at this point, the parties are waiting on a decision by the court.

h. **Observations.**

(1) **Gift by Beneficiaries Who Fail To Object to Improper Distributions, CCA 202352018.** The IRS may take the position that remainder beneficiaries make gifts to the spouse by not objecting and taking actions to prevent 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**. *See also* Rev. Rul. 81-264 (gift can occur by permitting legal rights to expire, but a transfer that one may rescind under state law might remain incomplete until the right to rescind expires).

(2) **Section 2519 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.

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*. (For a summary and discussion of the Tax Court cases in *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**.) *McDougall,* however, indicates that gift issues may arise for remainder beneficiaries when QTIP trusts are terminated early with the consent of the remainder beneficiaries.

(3) **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.

(4) **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*.

(5) **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. These types of transactions did not trigger §2519 in *Kite I*.

(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. The IRS may take the position that the improperly distributed assets should be treated as if they were still in the trust. For a discussion of the *Halpern*, *Hurford*, *Hartzell*, *Council*, *United Food*, and *Wyly* cases that are relevant to this issue, see Item 21f.(4)(b)(ii) of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**.

(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 28.h(6) 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 28.h(3) 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 28.h(1) 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.

(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.

(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 28.h(6) 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).

(6) **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 [H] or [the Children] (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 26 above) 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 remainder beneficiaries 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.

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 [H's] income interest (since that is the measure of C's potential amount realized), whereas C would prefer a high value assigned to [H'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.

(7) **Gift 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?

29. Tax Risks if Exempt and Non-Exempt Trusts Created Under a Trust Agreement Have Differing Terms, Private Letter Rulings 202507003 (Feb. 14, 2025), 202507005 (Feb. 14, 2025) and 202531005 (Aug. 1, 2025); Recent PLR (April 14, 2026)

a. **Brief Summary.** Private Letter Rulings (PLR) 202507003 (Feb. 14, 2025), 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 PLRs 202507003 and 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.

In PLR 202531005, the only differences between the exempt and non-exempt trusts were the beneficiary's testamentary powers of appointment over the trusts (with a formula general power of appointment over the non-exempt trusts).

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, PLRs 202507003 and 202507005, in the "express no opinion" paragraph, 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 may have subtly backed away from this position in a recently issued private letter ruling. The recent ruling, dated April 14, 2026, had similar facts (although the differences in the exempt and non-exempt trusts were not noted in the ruling), but the IRS did not include the "we express no opinion" paragraph in the new ruling.

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 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 PLRs 202507003, 202507005, and PLR 202531005.**

(1) **Overview of Trust Terms in PLRs 202507003 and 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 (in PLR 202507005, the spouse also held a testamentary power of appointment to appoint the assets among the donor's descendants). Notably, withdrawal rights and appointment powers of the child for each child's trust 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 PLRs 202507003 and 202507005) or "Donor's power to alter a beneficiary's testamentary power of appointment" (in PLR 202531005) through a late allocation of GST exemption–

- Would cause the trust to be includible in Donor's estate under §§ 2036(a)(2) and 2038, 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, PLRs 202507003 and 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. **Recent Ruling Without the Troublesome Paragraph**. ACTEC Fellow Lee Brown, Little Rock, recently received a PLR granting the right to make a late GST exemption allocation. Importantly the new PLR does NOT contain the paragraph "expressing no opinion" regarding whether a settlor's retained power to make a late GST exemption allocation could cause estate inclusion under §§ 2036(a)(2) or 2038 where the trust agreement included a general power of appointment for beneficiaries of non-exempt trusts but not for exempt trusts. The PLR has not yet been published.

Very interestingly, the facts in the new PLR make no mention of the differences in the non-exempt and exempt trusts under the trust agreement. The facts presented to the IRS made clear that children of the settlors had testamentary general powers of appointment over non-exempt trusts but only had testamentary limited powers of appointment over exempt trusts. The PLR merely says that "[e]ach child has a limited testamentary power of appointment to appoint their trust share to their descendants." Therefore, someone reading the new PLR would have no idea that the potential issue of possible estate inclusion exists because of differences in the non-exempt and exempt trust terms. But the attorney who received this ruling had detailed conferences with IRS officials in the process of obtaining the PLR, and they were well aware of the general power of appointment that applied for non-exempt trusts and were well aware of the "we express no opinion" paragraph that had been included in similar rulings in 2025. This may be the IRS's way of subtly backing away from this issue and may have changed its position about possibly taking the position that 2036-2038 applies in this circumstance.

d. **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 these rulings, 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 a 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).

e. **Huge Problem; Will the IRS Drop This Position?** 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 were informal indications in 2025 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 would pose substantial risk for taxpayers with similar trust structures. But, perhaps the IRS has changed its position in view of the recent PLR that did not include the "we express no opinion" paragraph.

f. **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 of appointment) 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. This risk of inclusion under §2036 or §2038 exists primarily for trusts for which the inclusion ratio is not zero.

(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 reasoning in the 2025 PLRs.

(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.(Section 2035 should not apply because a third party eliminated the problematic power not the grantor.) 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. 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.

30. 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, he 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 succinctly 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 has taken 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 was *Estate of Sakioka v. Commissioner*, T.C. Docket Nos. 7132-19 & 7138-19. The trial was set for Jan. 12, 2026, but the parties filed a Stipulation of Settled Issues on Dec. 22, 2025, which settled all remaining issues in the case (on terms favorable to the taxpayer).

(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 Item 30.c(5) 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.

(6) **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.

31. 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. Reg. §25.2702-3(b)(1)(i) and §25.2702-3(d)(6) provide that the issuance of a note by a GRAT in satisfaction of the annuity amount does not constitute payment of the annuity, and the IRS's brief confirms that is one of the reasons supporting its position. 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 gave no further insight as to the rationale for the gift conclusions in the deficiency notices. The taxpayers filed a Motion for Partial Summary Judgment on Oct. 1, 2025, requesting the court to determine that the annuity interests were qualified interests under §2702 and that the GRATs satisfied the qualified interest requirements of Reg. §25.2702-3. The IRS filed its response to that motion on Jan. 16, 2026, providing rationales for its positions in the case. *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. (Apparently, the value of HCA Healthcare, Inc., a significant investment in one of the two investment companies, appreciated greatly during that time period.)
- All the notes used in the transactions 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 were not made 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 powers and the use 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 in *Varian Medical Systems & Subsidiaries v. Commissioner*, 163 T.C. 76 (2024), reiterate that regulatory provisions cannot 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; Under *Loper Bright,* They 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 do not permit a GRAT to issue its own 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. **IRS's Response to Motion for Partial Summary Judgment.** The IRS filed its Response to Motion for Partial Summary Judgment on Jan. 16, 2026 (the Response). The Response's conclusion summarized its three major points:

(i) several issues of material fact remain in dispute;

(ii) the retained interests are not qualified interests within the meaning of §2702 and Reg. §25.2702-3 based on the objective facts of the transfers and the surrounding circumstances and did not meet the definition of and function exclusively as a qualified interest from the creation of the trusts; and

(iii) the qualified interest requirements of Reg. §25.2702-3 are valid under *Loper Bright* because they are the best reading of the statute and the taxpayers' interpretation would lead to unreasonable and absurd results.

The Response also points out that two of its positions were not addressed in the taxpayers' motion for summary judgment: (1) an alternative argument that if the retained interests are qualified interests, the reacquisition of the assets of the GRATs in exchange for unsecured, personal promissory notes resulted in taxable gifts by the taxpayers; and (2) the application of §6662 accuracy-related penalties.

(1) **Disputed Factual Issues and a Few Factual Observations.** A few of the factual disputes are: (1) taxpayers' motion omits numerous facts relating to the creation and operation of the GRATs (and the Response provides its own very detailed description of the facts); (2) the IRS does not stipulate the accuracy of any appraisal or valuation [***Observation:*** *the IRS's Answer, filed on July 9, 2025, did not object to any of the values of the assets contributed to the GRATs*]; and (3) the IRS does not stipulate that the promissory notes given to the GRATs in acquiring the GRAT assets or the transactions underlying such promissory notes constitute bona fide debt for federal tax purposes.

One of the interesting factual observations is that the GRATs were structured as "zeroed-out" GRATs that purported to eliminate any gift tax. Planners sometimes structure GRATs intentionally to leave a few dollars of gift. The IRS in this case has raised no objection to the GRATs being structured as "zeroed-out" GRATs.

The Response repeatedly states that the taxpayers provided no appraisal or other documentation evidencing the fair market value of the notes or demonstrating that they were worth their stated face amounts.

The IRS takes essentially opposite positions as alternative arguments – that the exercises of the substitution power to acquire GRAT assets were either "withdrawals" of assets from the GRATs or were additional contributions to the GRAT. The Response contends that the substitution of notes for the GRAT assets constituted withdrawals of value because the notes were not bona fide debt or alternatively contributed a prohibited additional contributions either because (1) the notes were worth more than the acquired assets because they had an interest rate in excess of the §7520 rate or (2) the use of the notes "to lock in the gain in the trust assets provided an additional economic benefit to the remainder beneficiaries of the trust." [***Observation:*** *that last position calls into question the entire process of monitoring the performance of GRATs and acquiring appreciated or depreciated GRAT assets in return for assets that have little value volatility, as reiterated in the Response's discussion of* Loper Bright, *discussed in Item* 31.f(4) *below*.)

The facts stated repeatedly that the use of a "debt instrument to satisfy the annuity amounts" is prohibited.

(2) **Material Facts Remain in Dispute.** Some of the purported disputed facts (which are suggestive of planning the IRS thinks is not allowed) are:

(1) Whether the pattern of using notes to acquire GRAT assets was "part of a single, integrated plan to depart from the original terms of the [GRATs] and distort the actuarial values of the retained interests";

(2) Whether the exercise of the swap power to acquire GRAT assets was used "to lock in appreciation or otherwise pass the value of the stock to her daughters";

(3) Whether the notes were simply accounting entries;

(4) Whether a similar planning pattern was used previously or subsequently by the taxpayers;

(5) Whether the taxpayers at the time the GRATs were created understood that the swap powers would be exercised and the notes would be used to satisfy annuity payments; and

(6) Whether the notes constituted "bona fide debt; *i.e.*, whether the notes were made with a real expectation of repayment and whether Petitioner's daughters would enforce the notes against her."

(3) **Not Qualified Interests.** Withdrawing assets from the GRATs at will in return for unsecured notes, on which payments were never made, and using the "capital account" on her notes to pay annuity payments demonstrated that the objective facts and surrounding circumstances indicate that the retained interests were not "the fixed payment structure" that would be a qualified interest under §2702(b)(1). In the words of *Deal v. Commissioner*, 29 T.C. 730 (1958), "the making and canceling of the notes were a mere device to enable the petitioner to avoid the gift tax." Response, at 81.

Reg. §25.2702-3(b)(1)(i) states that issuing a note, "directly or indirectly" in satisfaction of the annuity amount does not constitute payment of the annuity. The preamble to the issuance of that final regulation stated that "the step transaction doctrine will be applied where a series of transactions is used to achieve a result that is inconsistent with the regulations." The Response acknowledges that the taxpayers rather than the GRAT "issued" the notes used to make the annuity payments, but "the issuance of the notes and withdrawal of the other assets of the trusts operated to cause the trust to, directly, or indirectly, satisfy the amounts in a manner prohibited by Treas. Reg. §25.2702-3(b)(1)(i)." Response, at 84.

Reg. §25.2702-3(b)(1)(i) says a right of withdrawal is not a qualified annuity interest. The withdrawal of GRAT assets in return for notes "functioned as a prohibited withdrawal right" that "causes Petitioner's retained interests to fail as qualified annuity interests." Response, at 85. [***Observation:*** *The IRS position seems to be that any exercise of a substitution power to acquire GRAT assets in return for notes means the annuity interest is not a qualified interest so that the full amount transferred to the GRAT was a gift.*]

The Response cites *Atkinson v. Commissioner*, 115 T.C. 26 (2000), *aff'd*, 309 F.3d 1290 (11th Cir. 2002), *cert. denied,* 309 F.3d 1290 (2003) ("[t]hough the terms of the annuity trust met the letter of the statutory requirement[s]…, the trust did not operate in accordance with those terms" and, therefore, "the trust did not meet the express 5-percent requirement of the statute and cannot qualify for treatment as a charitable remainder trust"). "Here, like in *Atkinson*, it is not sufficient for Petitioner to establish trusts under the GRAT rules and then completely ignore the rules during the trusts' administration." Response, at 87.

Under traditional gift principles, "Commissioner may look to post-gift events to determine the substance of the transfer as of the date of the gift," and that applies to §2702. Response, at 88. Events occurring after the formation are relevant in determining whether the retained annuity payment were qualified interests.

(4) **Qualified Interest Requirements Of Reg. §25.2702-3 Are Valid Under *Loper Bright*.** "[T]he best reading of section 2702 is one that precludes the manipulation of value using early withdrawals to lock in gains and early terminations to capture price rebounds. Thus, the statute requires that, in form and substance, a qualified interest consists of the right to receive the statutorily required fixed payment amounts and that retained interests that are given value at the time of the transfer must reflect amounts that will *actually be paid* to the term holder." Response, at 92.

The legislative history demonstrates that the purpose of §2702 is to prevent valuation abuses for transfers in trust or for term interests. Congress intended that retained interests take an easily valued form and that retained interests must reflect actual amounts that will actually be paid to the term holder.

"A note is merely a promise to make a payment in the future," and "delaying payment by using a note to satisfy the annuity interest alters the true value of the grantor's retained interest, contrary to the statutory purpose of ensuring an accurate valuation of that interest." The regulation's prohibition of "the use of a note or other debt instrument in payment of the annuity, and the corollary provision that the use of a note or other debt instrument does not constitute payment of the annuity amount, are entirely consistent with the Congressional intent of making sure that the actual payments are consistent with the initial valuation assumptions." Response, at 96.

[***Observation:*** *This IRS position is that the "use," rather than the GRAT's "issuance" of any note to pay the annuity amount is prohibited*.]

"Accordingly, the best reading of section 2702 is one that obviates the manipulation of value using (1) early withdrawals to lock in gains, and (2) early termination to capture price rebounds." Response, at 97. [***Observation:*** *Again, this is a startling position that traditional GRAT monitoring planning would cause the entire transfer to a GRAT to be a taxable gift; this statement suggests the IRS maintains that highly appreciated or depreciated GRAT assets cannot be purchased from GRATs*.]

Skidmore factors support the validity of the regulation under a *Loper Bright* analysis.

The regulation prohibiting the "issuance of a note" to satisfy the annuity amount is a valid exercise of regulatory authority under §7805. *Loper Bright* said that a statute may empower an agency to "full up the details" of a statutory scheme or to regulate, and §7805 gives the IRS authority to "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." The GRAT regulation invokes §7805's mandate to prevent valuation abuses. Section 2702 does not define "fixed amounts" and does not constrain the IRS from exercising its §7805 authority to promulgate needful regulations. The "best reading" of §2702 is that, "in conjunction with section 7805, 'it delegates discretionary authority' to the Treasury Department to fill up the details." Response, at 101.

In summary, "each of the qualified interest requirements in Treas. Reg. § 25.2702-3 is in accord with the text, legislative history, and purpose of section 2702. Further, the regulation is a valid exercise of delegated rulemaking authority under section 7805(a) and constitutes a body of experience and informed judgment that is entitled to due respect."

g. **Taxpayer**s**' Reply to IRS's Response to Motion for Partial Summary Judgment**. The taxpayers' reply was filed March 5, 2026. The arguments included the following.

(1) **Plain Text.** The IRS cannot rewrite §2702's clear and unambiguous plain text, which provides the "best reading" of that statutory provision.

(2) **Regulations Add New Requirements.** The IRS improperly departs from §2702's plain text to add new requirements of its own making.

(3) **IRS's Deference Arguments.** The IRS's appeals to deference cannot save its rewriting of §2702.

(4) **Annuity Interests Meet §2702 Requirements.** The annuity interests meet §2702's textual requirements.

- The IRS concedes that under the trust terms, the annuity interests satisfy the statutory requirements for "qualified interests" under §2702.
- The IRS's post-valuation date, substance over form arguments are irrelevant and unavailing. The IRS's arguments, that the exercise of the power of substitution may have been an unauthorized withdrawal (if the note was not bona fide debt or if the note value was less than the value of the assets substituted) or may have been a prohibited additional contribution (if the value of the notes exceeded the value of the assets substituted), have no bearing on whether the grantor retained a qualified interest under §2702. They are independent transactions, and the IRS can make gift arguments for those specific valuation dates, but those values do not somehow "relate back" to the GRAT creation to mean the annuity interests are not "qualified interests" under §2702.
- In response to the IRS's argument that the issuance of notes by the grantor "operated to cause the trust to, directly or indirectly, satisfy the annuity amounts in a manner prohibited by Treas. Reg. § 25.2702-3(b)(1))i)," the taxpayers respond that the regulation "merely prohibits the trustee from **issuing** a note in satisfaction of the annuity; it does not prohibit a trustee from **offsetting or discharging** a note owned by the trust in

satisfaction of the annuity…. Stated another way, a trustee of a GRAT is not allowed to satisfy an annuity with a so-called 'IOU'." (emphasis in original)

- "In the 35 years since Congress enacted § 2702, no case or IRS ruling has ever reached a conclusion consistent with the position asserted by Respondent, even though the challenged transactions have been a common estate planning technique for nearly three decades." The Reply (in footnote 8) cites three articles (the first being in 1999) stating that successful investment results can be locked in by purchasing GRAT assets in exchange for a promissory note.

h. **IRS's Reply to Reply to Response to Motion for Partial Summary Judgment.** The IRS filed its Reply on April 6, 2026. (The Reply noted, in footnote 1, that the transactions were undertaken by Mrs. Elcan, and Mr. Elcan is part of the case solely as a result of his election to split the gifts made by Mrs. Elcan, so the Reply refers to her as the "Petitioner.") Some of the arguments are summarized.

- Post-formation actions are relevant in determining whether the taxpayers retained a qualified interest. Issues include:
  - "Whether the pattern of Petitioner's post-transfer withdrawals of dividends and stock in exchange for her own promissory notes and the later use of those notes to satisfy the annuity payments were part of a single, integrated plan to depart from the original terms of the 2018 Trust Agreements and distort the actuarial values of the retained interests,"
  - "Whether, in the years prior to or after 2018, Petitioner engaged in a similar pattern of creating annuity trusts, substituting promissory notes for the trusts' dividends and assets, and later reducing the balances due on the notes in satisfaction of the annuity payments,"
  - "Whether the dates Petitioner selected for the withdrawal of assets from the 2018 Trusts in exchange for her promissory notes were related to developments within HCA Healthcare, Inc. ("HCA"), as opposed to the terms of the trust agreements,"
  - "Whether the notes Petitioner substituted for the dividends and assets of the 2018 Trusts constituted bona fide debt, and"
  - "Whether the fair market value of the notes issued by Petitioner to the 2018 Trusts in substitution for the trusts' assets was equal to the fair market value of the substituted assets as of the date of substitution."
- Taxpayers' retained interests do not meet the statutory definition of a qualified interest under §2702(b)(1).
  - Taxpayers did not retain the right to receive "fixed payments" under §2702(b)(1). Taxpayers did not obtain an appraisal or other documentation demonstrating that the value of the notes was equivalent to the value of the trust assets that were withdrawn. There were never any actual payments of interest or principal made with respect to the promissory notes issued by the taxpayers to the trusts, calling into question the bona fide nature of such notes.
  - The operation of the trusts is relevant to determining whether taxpayers retained qualified interests. "They did not retain the right to receive fixed amounts "payable" no less frequently than annually…. The ordinary meaning of pay is "to make a disposal or transfer of (money)" [citing the Merriam-Webster dictionary and Black's Law Dictionary]. In simple terms, there was no transfer of money by the 2018 Trusts so as to constitute a "payment" within the ordinary meaning of the word." [***Observation:*** This is another startling comment by the IRS, that annuity payments for GRATs must be paid in "money." For the last 35 years, the IRS has never raised objections to having annuity payments made in kind with assets other than money.]

- The fair market value of the notes could not equal their face amount. All of the GRATs' assets were acquired in the substitution for the notes, and "were no longer available to Petitioner to pay the demand note payable…. And even assuming that the notes were bona fide, given their lack of security, marketability, and liquidity, as well as the fact that the withdrawn assets were no longer available to satisfy the demand notes, the fair market value of the notes could not equal their face amount." [Observation: This argument is similar to the argument the IRS made about the valuation of notes in *Galli*. The court did not agree in that case, as discussed in Item 18 below.]

- Taxpayers attempt to distinguish post-formation events as "independent transactions that have their own consequences, but the pattern of withdrawing assets in return for notes and reducing the face amount of the notes to satisfy annuity amounts "is clearly relevant" to whether the taxpayers retained qualified interests.

- Taxpayers violated multiple provisions of the trust agreements. "Each time Petitioner withdrew the assets of the 2018 Trusts in exchange for her personal notes, she left behind no assets with which the trusts could make the annuity payments and then caused the trusts to satisfy the annuity payments with the functional equivalent of the issuance of a note, i.e., reduction of the face amount of her own notes."

- The qualified interest requirements of Reg. §25.2702-1 are relevant and valid. They are a valid exercise of Treasury's Congressionally delegated rulemaking authority under §7805's specific delegation to "prescribe all needful rules and regulations…" *Lesko v. United States*, 161 F.4th 1352 (Fed. Cir. 2025), upheld regulations under *Loper v. Bright*'s recognition of additional deference when a statute delegates discretionary rulemaking authority to an agency. [**Observation:** But the specific statutory Act addressed in *Lesko* expressly authorized regulations as may be "necessary for the administration of" the Act.]

- The retained interests do not satisfy the qualified interest requirements of Reg. §25.2702-3. Even though the trustee did not issue a promissory note in payment of the required annuity amounts, Reg. §25.2702-3(b)(1) "is not limited to the issuance of a promissory note by the trustee and specifically includes the phrase 'directly or indirectly.' The use of promissory notes or other similar arrangements to satisfy the annuity amount, regardless of whether the note is issued directly by the trustee in payment of the annuity amount, raises concerns regarding the timing, nature, and amount of the annuity payment. This point is further clarified in the preamble to the final regulations, which explains that the step-transaction doctrine could be applied where a series of transactions is used to achieve results inconsistent with the regulations."

i. **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 against GRATs." 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 appears not to 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), but the IRS's Response to Motion for Partial Summary Judgment does not stipulate to the accuracy of any appraisal or valuation. 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 *Elcan* 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 taxpayers' 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).

Furthermore, Section 3 of Executive Order 14219, dated Feb. 19, 2025, 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 …"

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) **Planning Alternative – Spousal Loan.** Another alternative is for the grantor's spouse to borrow the cash from the trust (which the spouse could use to pay income tax on the spouses' joint income tax return). Distribution of the spouse's note to the grantor in satisfaction of the annuity payment would not in any way seem to violate the regulations.

(8) **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.(The IRS has made the "prohibited additional contribution" argument in several cases where a higher interest rate than the §7520 rate was used for the grantor's note to the trust.) 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.)

(9) **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.

32. 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).

33. 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]he 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 2024 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 reacquired 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 ownership 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 2024 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. **Best Practices for GRATs With Insider Stock.** If an insider contributes stock to a GRAT, structure the GRAT so the facts will be close to those of the *AutoZone* case. The insider should be the grantor and the sole trustee or have sole investment authority. In addition, the insider stock should be the only asset contributed to the trust (so there would be no argument that the insider as trustee makes a decision between distributing the insider stock or other assets when making annuity distributions).

i. **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 LLC member interests to the GRAT and from the GRAT as annuity payments would not be reportable. Therefore, securities litigators scouring the SEC reports to find insider stock that has been contributed to GRATs would not locate the transaction.

j. **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).

34. 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 provided 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.

e. **Portability Should Always Be Discussed with Fiduciaries of 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.

35. Compensatory Split Dollar Arrangement; Whether Benefits From a Compensatory Split Dollar Agreement With a Shareholder-Employee Will Be Treated as Shareholder Distributions Rather Than as Compensation, *McGowan v. U.S.,* 136 AFTR 2d 2025-5113 (6th Cir. July 9, 2025), Signaling Reversal of *Machacek v. Commissioner*

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 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. **Detailed Discussion.** For a more detailed discussion of *McGowan* and planning implications of the likely reversal of Machacek, see Item 36 of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

36. Divorce Proceeding, Treatment of Irrevocable Trusts for Descendants in Divorce of Settlors, *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 an $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 considered in making an equitable division of property on divorce. Even though the trust assets may not be awarded to a spouse, they may be considered in determining a "just and proper" division of non-trust marital assets.

On Sept. 30, 2025, the New York Appellate Division stayed enforcement of the judgment pending appeal.

Dana Fitzsimons (Bessemer Trust) offers this pithy summary of C.S. v. R.H.:

- Here you have third-party settled irrevocable trusts for children and grandchildren. The family homes are in the trusts along with a lot of their wealth. Husband and wife both gift marital property to the trusts and use exemptions.
- You've got very colorful facts here.
- Fairy-tale story – financial success, healthy and successful children, multiple homes, fancy Hamptons estate, travel, and art collecting.
- Husband manages all the family finances, and is investment advisor for the trusts, they lived rent-free in the houses, and the trusts supported their lifestyle.
- If "2036" didn't just flash in your brain, you need to come to Heckerling more often.
- Then life happens.
- Husband gets hurt skiing and wife gives up work to take care of him. He battles cancer. They struggle with one of their kids.
- Wife has a drinking problem and husband has an affair. Wife files for divorce.
- Husband installs his friend as trustee, removes wife as director of the LLCs in the trusts, decants the trusts to keep the assets in trust and expand his power, and adds more marital property to the trusts.
- Evicts wife, removes her things, hangs up a picture of his new girlfriend, changes the locks, and bulldozes her vegetable garden.
- That was the last straw for the court – not so much the infidelity, but the vegetable garden.
- The court pulls the trusts into the equitable distribution calculation in the divorce, because the trusts held most of their assets, they lived out of them, husband had all the control, and all this was his idea – and he only told his wife about it when they were on a ski lift, at dinner, or not at all.
- The court can't dissolve the trusts, but it gives wife all the non-trust assets and $36 million on top.
- And tells husband to borrow from the trust if he doesn't have the money.
- That case is now on appeal so stay tuned.

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 an $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/month 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 – in making an equitable division of property on divorce, 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. That court's conclusion has been controversial for New York family law purposes.

(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.)

e. **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.

37. 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 case 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 to pierce into the trust to satisfy the judgment. The trust, however, had been established and funded long before these claims arose.

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 sometimes 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 sitused 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 were 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 *Hube*r reasoning. *See* Steve Oshins, *In the Matter of the CES 2007 Trust: Delaware Court Says Domestic Asset 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) ***Battley v. Mortensen***, Battley v. Mortensen is a federal bankruptcy case. Alaska DAPT assets were treated as part of the bankruptcy estate. Bankruptcy Code §548(4) allows a

bankruptcy trustee to avoid any transfer to a self-settled trust by a debtor made with actual intent to hinder, delay, or defraud a creditor, and the trust's express purpose was to protect the trust assets from creditors. *Battley v. Mortensen*, Adv. D.Alaska, No. A09-90036-DMD (May 26, 2011) (original memorandum) (Jul. 18, 2011 (memorandum denying motion for reconsideration)

(d) ***U.S. v. Huckaby.*** *U.S. v. Huckaby* held that California real estate in a Nevada Spendthrift Trust created by California residents could be reached by creditors under conflict of laws principles (applying the law of the situs as to real property in the trust). See Item 40 below.

(e) **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).

(f) **Strong Public Policy Issue; Uniform Trust Code §107; Restatements.** The "strong public policy" issue is also addressed in § 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.

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.

(g) **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, *Fourteenth ACTEC Comparison of the Domestic Asset Protection Trust Statutes* (updated through August 2025).

(h) **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 DAPT 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.")

38. 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.** Husband and Wife created an irrevocable grantor trust (the Seldin Grantor Trust) in 2002 and another in 2004 (the Grandchildren's Trust), both funded with their community property. In 2015, the Grandchildren's Trust was divided into six separate irrevocable grantor trusts for their grandchildren. The seven irrevocable grantor trusts are referred to collectively as the Grantor Trusts. The Grantor Trusts contributed various amounts to Belmont Investments, LLC (Belmont), and in December 2018, the Grantor Trusts collectively owned 91.824% of the member interests in Belmont.

Wife died on December 14, 2018. Thereafter, each of the Grantor Trusts was no 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 of the Grantor Trusts 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). The trustee presumably disproportionately allocated other assets to equalize the values of Husband's and Wife's portions of the Grantor Trusts.

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 INTEREST 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 depreciation 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 to have 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.** Item 2 of the 2022-2023 Treasury-IRS Priority Guidance Plan was described as "Guidance regarding availability of §1014 basis adjustment at the death of the owner of a grantor trust described in §671 when the trust assets are not included in the owner's gross estate for estate tax purposes." That item in the 2022-2023 Plan was apparently the IRS's response to a statement by Secretary of the Treasury Janet Yellen 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. This item was omitted from the 2023-2024 Priority Guidance Plan.

(4) **Revenue Ruling 2023-2.** Rev. Rul. 2023-2, IRB 2023-16 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 to have 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 probate 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).

A possible alternate reading of §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.

One reported case has directly addressed this matter. *Collins v. United States*, 318 F. Supp. 382 (C.D. Cal. 1970), *aff'd*, 448 F.2d 787 (9th Cir. 1971). In that case, the decedent's employer promised to pay a widow's death benefit (monthly payments for five years or the widow's earlier death) if he died while employed with the company. The negotiated death benefit was to induce the decedent's continued employment and was therefore community property. The decedent included his one-half of the present value of the death benefit in his gross estate. The widow sought a refund of income taxes paid with respect to payments in three particular years, taking the position that a basis adjustment under §1014(a) would eliminate the income tax. The IRS argued that "§ 1014(a) gives no independent right to a stepped-up basis, that the right to a stepped-up basis is limited to situations within the specific categories defined in §1014(b)." The district court viewed this matter as a case of first impression. It agreed with the IRS's position, giving two reasons. First, it viewed the wording of §1014(b) to reflect an intent "to mark the limits of property acquired from a decedent or passing from a decedent as those terms are under in subsection (a)." A footnote explains:

> Particularly to be noted are the initial phrases of subsection (b) which read: "For the purposes of subsection (a) the following property shall be considered * * *." The phrases link the two sections and suggests that (b) was specially designed to define the more general terms used in (a).

Second, it pointed to the legislative history.

> The legislative history of the 1954 Internal Revenue Code would appear to support that conclusion. The Senate Report gave the following terse explanation of the relationship between subsections (a) and (b):
>
> "The general rule is stated in the preamble to subsection (a) as applicable to property in the hands of a person acquiring the property from the decedent or to whom the property passed from the decedent * * *."
>
> "Paragraphs (1) to (9) of subsection (b) describe the circumstances under which property is treated as having been acquired or having passed from the decedent." S.Rep.No. 1622, 83d Cong.2d Sess., 3 U.S.Code Cong. & Ad.News, p. 5066 (1954)
>
> The Senate Report clearly implies that property must meet the definition of at least one of the 9 categories of subsection (b) before it can be considered as passing from or acquired from a decedent, and thus be eligible for a stepped-up basis under subsection (a). I so hold.

For some reason, the taxpayer in *Collins* did not argue that §1014(b)9) was applicable even though the decedent's one-half community property interest in the value of the widow's death benefit was included in the decedent's gross estate. That would not have mattered, because the court also held that the contracted death benefit was income in respect of a decedent, so §1014(c) precludes any basis adjustment under §1014.

The Ninth Circuit affirmed "on the opinion of the district judge" with no further elaboration.

In any event, the IRS has clearly stated its view and cited *Collins* in support of its position.

(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**.

39. Residence Sold to Son Included in Gross Estate; Transferee Liability To Find Executor Personally Liable for Estate Tax, *Estate of Spenlinhauer v. Commissioner*, T.C. Memo. 2025-134 (Dec. 30, 2025)

a. **Brief Summary.** The executor (the decedent's son) filed the estate tax return eleven years late with various errors and dubious valuations. The court included a residence that the decedent had sold to her son in the gross estate under §2036(a)(1) because the decedent continued to live in the residence and the intra-family sale was not shown to be a bona fide sale for adequate and full consideration. The court also sustained a multi-million-dollar estate tax deficiency and (importantly) held the executor/residuary beneficiary personally liable as a transferee after he distributed essentially all estate assets to himself. The court upheld the §6651(a)(1) failure-to-file penalty, rejecting the "reliance on an accountant" argument. Various other issues were all decided in the government's favor. *Estate of Spenlinhauer v. Commissioner*, T.C. Memo. 2025-134 (Dec. 30, 2025) (Judge Ashford).

b. **Basic Facts.** The 95-year-old decedent died February 4, 2005. Her son served as executor and was also the residuary beneficiary of her estate. Although the estate obtained an extension to file Form 706 until May 4, 2006, no return was filed by that deadline. The return was ultimately filed on February 8, 2017 – nearly eleven years late – after the IRS identified the missing estate return during the executor's bankruptcy proceedings. By then, the executor had already distributed (largely to himself) the estate's assets, leaving the estate insolvent when the IRS asserted a deficiency and additions to tax and pursued transferee liability against him.

In 1998, decedent transferred her residence in Milton, Massachusetts to her son in exchange for his promissory note. The note was later modified shortly before her death to add a self-cancelling feature (i.e., the remaining balance would be cancelled at her death). Despite the transfer, decedent continued to live in the Milton residence until she died, with no meaningful change in her day-to-day possession and enjoyment of the property.

The son had objected to the sale of a closely held company in which the decedent owned a 1% interest, and sued the other shareholders, incurring legal fees over $500,000.

The taxpayer represented himself in the Tax Court proceeding; there is no indication in the opinion that he is an attorney.

c. **Court Analysis.**

(1) **Section 2036 Inclusion of Residence That Had Been Sold.** The decedent transferred the Milton property to her son in 1998 in exchange for a promissory note, but she continued to reside in the property until her death. The court held that the property's value was includible in the gross estate under §2036(a)(1) because the decedent retained possession/enjoyment and the estate failed to establish the exception for a bona fide sale for adequate and full consideration. Two facts were especially damaging: (1) the executor could not substantiate actual payments on the note (offering only estimates and no meaningful documentation), and (2) the note was amended shortly before death to add a self-canceling feature, reinforcing the court's conclusion that the

arrangement did not reflect a commercially realistic debt that the parties reasonably expected to be repaid. (The decedent would have had to live to age 125 to be paid in full.) The full date of death value of the residence was included in the gross estate.

(2) **Failure To File Penalty Under §6651(a)(1).** The court sustained the §6651(a)(1) addition to tax because the Form 706 was filed far beyond the extended due date, and the executor failed to show "reasonable cause." The executor argued reliance on an accountant, but the evidence showed the accountant expressly cautioned that he lacked estate tax expertise and did not prepare estate tax returns, and the executor also failed to provide key information needed to prepare the return (including an appraisal). Under those facts, reliance did not constitute reasonable cause.

(3) **Transferee Lability, §6901, and Massachusetts Fraudulent Transfer Law.** The executor-son was personally liable for the estate tax and penalties as a transferee under §6901 (a procedural collection mechanism), because state law supplied the substantive transferee liability. Applying the Massachusetts Uniform Fraudulent Transfer Act (as the relevant state-law framework), the court concluded that transferring estate assets to the executor/residuary beneficiary left the estate insolvent and was fraudulent as to the IRS as a creditor. The executor's transferee liability was limited to the value of the assets he received.

(4) **Elections, Valuation Adjustments, Administrative Expense Deductions.** Because the Form 706 was untimely, the court rejected time-sensitive elections (including alternate valuation under §2032 and the qualified conservation easement exclusion under §2031(c)). The court also sustained major valuation adjustments and disallowed several claimed §2053 deductions for lack of substantiation and/or because the expenditures were viewed as benefiting the beneficiary rather than being essential to estate administration.

d. **Observations.**

(1) **Section 2036 Inclusion for Sale of Residence With Continued Use; Note Not Bona Fide Debt.** If the transferor continues to live in transferred property, the estate should expect §2036 scrutiny, particularly where, as here, the executor testified that "the purpose of the sale was to make sure decedent did not hold any property in her name when she died." The court concluded that the sale was not a bona fide sale for adequate and full consideration because of the lack of credible payment history (the son testified that he paid less than what was required by the terms of the note) and behavior inconsistent with forming a debtor-creditor relationship. The late-life addition of a self-canceling feature where the parties could not have reasonably expected the debt would be repaid in full further suggested the lack of a legitimate debtor-creditor relationship.

Even if the sale itself had been for full consideration, the continued use of the residence by the decedent raises the §2036 issue. If the decedent pays full consideration for the right to use the residence, the trend of the cases is not to apply §2036. *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 the court found that an agreement existed for the decedent to pay fair market rent; residence not included in estate). In *Spenlinhauer*, the court made no reference to any rent being paid for continued use of the residence.

(2) **§6651(a)(1): "Reliance on an Advisor" Is Not a Blanket Defense – Competence and Complete Information Are Key.** Where the fiduciary knows the advisor lacks estate tax expertise (or the fiduciary withholds critical data), reasonable cause becomes very hard to prove, particularly with an 11-year delay. *See also Estate of Fields v. Commissioner*, T.C. Memo. 2024-90 (reasonable cause exception did not apply; no specific evidence that any professional advised that the assets could be reported at the claimed discount); *Estate of Helen P. Richmond v. Commissioner,* T.C. Memo. 2014-26 (reasonable cause exception did not apply to avoid

undervaluation penalty; executor relied on an unsigned draft report by an accountant who had some experience preparing appraisals, having written 10-20 valuation reports, but who did not have any appraiser certifications).

(3) **Distribution Before Resolving Transfer Tax Exposure Can Create Personal Collection Exposure.** Even if state probate law duties are followed, distributing substantially all assets without reserving for potential tax liabilities can set up executor personal liability for estate tax and transferee liability where the distributee is the executor himself.

(4) **Self-Canceling Notes.** For a detailed discussion of self-canceling notes, see Stephen Akers & Philip Hayes, *Estate Planning Issues With Intra-Family Loans and Notes*, 38 ACTEC L.J. 51, 161-175 (Fall/Winter 2012).

40. California Real Estate in Nevada Trust Created by California Resident Not Protected from IRS Levies Under Conflict of Laws Principles, *United States v. Huckaby*, No. 2:23-cv-00587-DAD-JDP (E.D. Calif. March 2, 2026)

a. **Brief Summary.** Two individuals (Defendants) who were California residents transferred a California real estate property that they owned as joint tenants to a "Nevada Spendthrift Trust" in 2011 (one month after being served with an IRS levy that eventually resulted in a 2018 judgment against Defendant Huckaby). Defendants were the trust's settlors, trustees, and its sole beneficiaries during their lifetimes. The United States filed a motion for summary judgment seeking to enforce the IRS lien against the California property. Nevada has a domestic asset protection trust statute, but the Nevada trust apparently did not satisfy the Nevada statute because there was no Nevada trustee. The court did not address the application of the Nevada statute but determined under conflict of laws principles that the law of the situs (California, where the real property was located) governed as to whether trust property could be reached by creditors. The court cited §280 of the Restatement (Second) of Conflict of Laws ("[w]hether the interest of a beneficiary of a trust or an interest in land is assignable by him and can be reached by his creditors, is determined by the law that would be applied by the courts of the situs"). California does not recognize creditor protection for self-settled trusts. The court concluded that Huckaby had a property interest in the property as the trustee and beneficiary of the trust and that, "applying California law regarding the effectiveness of a spendthrift trust in shielding property from creditors," the liens were enforceable to the extent of Defendant Huckaby's interest in the property. *United States v. Huckaby*, No. 2:23-cv-00587-DAD-JDP (E.D. Calif. March 2, 2026) (granting plaintiff's motion for summary judgment in part).

b. **Observations.**

(1) **Terrible Facts.** This was a classic bad facts case. The bad facts included that (1) the original transfer to the trust was possibly a "voidable transaction" (i.e., fraudulent conveyance), (2) Defendants were California residents, (3) Defendants were sole trustees of the trust, (4) Defendants were the sole beneficiaries of the trust, (5) the trust property subject to the foreclosure claim was real estate located in California, and (6) the creditor is the United States for a tax lien. On these facts, it is not surprising the IRS could reach the real estate in this Nevada Spendthrift Trust.

(2) **LLC Wrapper.** If the real estate had been in an LLC, the court's analysis likely would have been different because member interests in LLCs are typically treated as intangible assets personal property. The analysis would have used other conflict of laws principles than the real estate situs principle or would have considered whether the trust qualified as a domestic asset protection trust under requirements of the Nevada statute.

(3) **Other Conflict of Laws DAPT Cases; "Hybrid DAPTs"; "SPATs."** See Item 37.e(6) above (in the discussion of *In the Matter of the CES 2007 Trust*) for a discussion of other conflict of laws cases involving DAPTs and see Item 37.e(4) above regarding structuring a trust as a "hybrid DAPT" or "SPAT," particularly when a trust in a DAPT state is being created by a resident of a state that does not have a statute protecting domestic asset protection trusts.

(4) **Resource.** For a discussion of *U.S. v. Huckaby*, see Steve Oshins, *New DAPT Case:* United States v. Huckaby, LEIMBERG ASSET PROTECTION PLANNING NEWSLETTER (Mar. 16, 2026).

41. APPENDIX – Summaries of Selected Tax Provisions in OBBBA and Background issues

a. **Introduction to the Act**. The primary legislative focus of Congress in 2025 was 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).

Of interest to many clients was whether the federal estate and gift exclusion amount (about $14 million in 2025) 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 had 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 came 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. **Overview of Selected Tax Cuts Under the Act.** The Act indefinitely extended the TCJA (with some modifications), indefinitely extended business provisions in the TCJA that had already expired, and added various other new tax cuts (some of which last only for five years). Unless indicated to the contrary, all of these tax cut provisions were 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).

Unless stated otherwise, all the provisions in the Act described below became 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.)

c. **Estate Tax.** The federal estate and gift exclusion amount ($13.99 million in 2025) not only did not revert to about $7 million in 2026, but the exclusion amount was 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 change of the estate tax basic exclusion amount in §2010(c)(3) also automatically adjusted the gift tax exemption amount (§2505(a)(1)) and the GST exemption amount (§2631(c)). Significantly, the Act did 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)

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

e. **Increased Standard Deduction; No Personal Exemption.** The personal exemption was terminated and the increased standard deduction was permanently extended and enhanced; it is $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).

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

g. **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 were 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) is increased from $5,000 to $7,500 for single individuals and married couples filing jointly beginning in 2026. (It is not indexed for inflation.)

h. **Qualified Business Income.** The §199A deduction for qualified business income (QBI) was 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 prior 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 was 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 now eligible for a minimum deduction of $400, indexed for inflation. ($737 billion cost)

i. **State and Local Tax Deduction.** The $10,000 cap on the deduction for state and local income, sales, and property taxes (SALT) was 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 availability 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).

j. **Home Mortgage Interest.** Limitations on the deduction of mortgage interest and home equity interest were 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 restored the deduction of mortgage insurance premiums (deductible as mortgage interest under the same cap).

k. **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, was extended permanently. (This means that many deductions described in the Code now may no longer be deducted. Perhaps all those "undeductible deductions" are left in the Code so they could easily be reinstated by a simple amendment to 67.) 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.

l. **Pease Limitation Replacement**.

(1) **General Description.** The Act replaced 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 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). This would be ($800,000 + $200,000) - $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, but from a literal reading of the statutory provisions, the limitation would apply to those items.

(a) **Section 68 Generally Applies to Estate and Trusts.** New §68(a) applies "[i]n the case of an individual," but §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." Section 68(e) previously provided that §68 does not apply to trusts and estates, but the Act deletes §68(e) for years beginning after December 31, 2025. 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 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 expense 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. Even though expenses unique to trusts and §651 and §661 distribution deductions are not treated as suspended "miscellaneous itemized deductions" under §67, they are still "itemized deductions" and therefore are subject to §68.

Applying the 2/37ths reduction to distribution deductions means that **double taxation** of about 5.4% of the 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). For example, if a trust has $1 million of income, all of which is distributed to a beneficiary, the income beneficiary would be taxed on $1 million, but the trust would get a distribution deduction of only $946,000, meaning that $54,000 is also taxed to the trust. The same $54,000 of income is taxed to both the individual and the trust, resulting in an additional (totally inappropriate) $20,000 of income tax to the trust (a double tax).

(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.

(e) **Guidance from IRS?** The IRS is unlikely to take a position that would result in *double taxation* of the income of trusts and estates and therefore is likely to continue with the approach in Reg. §1.67-4(a)(1)(ii) that distribution deductions are not itemized deductions and therefore cannot be subject to the 2/37ths cutback of itemized deductions under §68. The double taxation concern does not exist, however, for expenses unique to trusts and estates, and the IRS may take the position that the deduction for unique trust and estate expenses is subject to the 2/37ths cutback under §68. This issue is not on the Treasury-IRS Priority Guidance Plan for 2026. Instructions for 2026 Form 1041 may address this issue and hopefully will state that the 2/37ths cutback under §68 does not apply to distribution deductions in order to avoid a possible double taxation of 5.4% of the income of trusts and estates.

The §68 2/37ths cutback applies beginning in 2026. Most trusts are on the calendar year; therefore, reporting decisions about whether the cutback applies to unique trust expenses and the distribution deduction for trusts will arise in 2027 when trusts file their 2026 income tax returns.

(f) **Comments from New York State Bar Tax Section.** The New York State Bar Tax Section on Dec. 1, 2025, submitted interesting comments to the IRS regarding the impact of revised §68 on trusts, estates, and their beneficiaries. Observations from those comments follow.

- Congress and regulations have sometimes defined a trust and estate's adjusted gross income (AGI) differently for different purposes; there is no one definition of AGI that applies to trusts and estates.
- Unique expenses, the distribution deduction, and charitable deductions for trusts and estates are not clearly excepted from being itemized deductions; if they are itemized deductions (rather than deductions in arriving at AGI), they would be subject to the 2/37ths reduction under §68 and other relevant statutes.
- Distribution deductions are designed to avoid double taxation. Accordingly:

- The Treasury and IRS should determine if they have the authority to treat distribution deductions as non-itemized deductions for purposes of §68;
- The Treasury and IRS could seek a technical correction making clear that distribution deductions are not subject to §68; and
- If there is no technical correction legislation, the Treasury and IRS "could consider issuing guidance that the distribution deductions are treated, for Section 68 purposes, not as deductions but as allocations. In that way, Section 651 and Section 661, though technically styled as deductions, would not be subject to Section 68."

- All trust and estate administrative expenses should be subject to §68; therefore, the §67(e) definition of AGI should not be incorporated into §68.
- As a policy matter, the charitable deduction for estates should not be an itemized deduction (so, not subject to the 2/37ths reduction under §68), but for trusts they should be an itemized deduction (so, the 2/37ths reduction would apply).
- Treasury and the IRS should clarify that in computing the §68 reduction amount, a hypothetical computation of distributable net income, determined without regard to §68, is required.

(g) **Section 642(c) Charitable Deduction.** The charitable deduction for trusts and estates under §642(c) is discussed in Paragraph (o) below.

(h) **Planning Alternatives To Avoid Double Taxation Because of the Application of §68 to Distribution Deductions.** A practical alternative is to "wait and see." The double taxation was most surely not intended, and the IRS may take the position in formal guidance or in the Instructions to the 2026 Form 1041 that the 2/37ths reduction does not apply to the distribution deduction. Return preparers will have to make the decision in 2027, when filing 2026 trust income tax returns, what position to take regarding the availability of the distribution deduction. Hopefully, the IRS provides favorable guidance by that time.

Another alternative would be available if the trust provides (or is amended to provide) that the trustee could grant a withdrawal power to a current beneficiary. The trustee could, prior to the beginning of a year, grant the beneficiary a withdrawal right over a dollar amount equal to the anticipated income in the following year. The income within that withdrawal amount would be taxed directly to the beneficiary under §678 rather than being taxed to the trust, so no double tax would result. (If the trustee guessed wrong as to the anticipated income amount, the amount could be adjusted appropriately for the subsequent year.)

(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 2/37ths cutback of the §691(c) deduction makes accelerating IRD before death more attractive.

(6) **ACTEC Comments.** On November 10, 2025, ACTEC 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).

m. **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 was made permanent (otherwise, it would have reverted back to a 50% limitation in 2026).

(2) **0.5% Floor on Charitable Deductions.** A new floor applies in determining total individual charitable deductions. Contributions are 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 Appendix, Paragraph o below.

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. If an individual does not have substantial deductions other than charitable deductions, "bunch" charitable contributions (say, once every four years), which would permit the individual to take advantage of the standard deduction in the other three years, including the $1,000/$2,000 above-the-line charitable deduction in those other years (discussed immediately below).

(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. The Tax Foundation estimates that the number of taxpayers taking this above-the-line deduction will increase dramatically under the Act; nearly 86 percent of taxpayers will likely take the standard deduction in 2026. *See* Emily Kraschel & Erica York, *Changes to Charitable Giving Under the One Big Beautiful Bill Act*, TAX FOUNDATION (Nov. 2025), **https://taxfoundation.org/blog/charitable-deduction-big-beautiful-bill/**

(4) **$1,700 credit for Contributions to Scholarship Granting Organizations (Beginning in 2027).** A new $1,700 credit is available under new Section 25F 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.

n. **Corporate Charitable Deductions.** Corporations may deduct up to 10% of their taxable income, . but a new 1% floor was imposed beginning in 2026. 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 it "will generate a significant degree of name recognition and goodwill in the communities where it operates and thereby increase its revenue."

o. **Trust and Estate Charitable Contributions; Impact of 2/37ths Reduction of Itemized Deductions.** The charitable deduction for trusts and estates under §642(c) is an itemized deduction; accordingly, the 2/37ths cutback under §68 would seem to apply to the charitable deduction for trusts and estates.

A possible argument to avoid that result is that §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%, under § 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), says 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 2/37ths 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 2/37ths 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 2/37ths 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 2/37ths 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. 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 2/37ths 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 2/37ths 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 2/37ths 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 2026). 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.

p. **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, but the Act did not include that provision.

Expansion of Qualified Small Business Stock (QSBS) Gain Exclusion. The Act made three significant changes, applicable for QSBS issued or acquired on or after July 4, 2025 (the date of enactment). These changes and the enhanced planning opportunities available for QSBS are discussed in Item 15 above.

q. **Gambling Losses.** Gamblers were dealt a bad hand in the Act—the deduction for "losses from wagering transactions" is limited to 90% of the losses (only to the extent of the gains from such transactions). The bipartisan FAIR BET Act (Fair and Accurate Income Reporting for Betting Expenses Act) has been introduced to reverse that change made in the Act.

r. **Educator Expenses.** The $300 above-the-line deduction for educator expenses was 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.

s. **Selected Business Provisions (Generally Effective in 2025); Disguised Payments for Services to a Partner**. Several business provisions in the TCJA that had already expired were 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 prior 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)

Section 707(a)(2) gives the IRS the power to recharacterize partnership distributions for services as compensation income rather than being taxed as typical partnership distributions. Under prior law, the section said, "under regulations prescribed by the Secretary," and that clause was eliminated in the Act. No regulation has been promulgated for decades, and this change in the Act removes any question about the section being unenforceable until regulations are issued. This provision in the Act applies to services performed and property transferred after the date of enactment. A rule of construction added that the change shall not be construed to create any inference with respect to the proper treatment under §707(a) of partnership payments prior to the date of enactment. This

seemingly innocuous change is expected to generate over $12.4 billion of added revenue over two years.

t. **Clean Energy Credits.** The Act repealed or phased 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 is disallowed for any expenditure made after 2025 (moved up from Dec. 31, 2024) and the clean vehicle credit is 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.).

u. **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 extended the benefits of investments in QOFs **beginning in 2027**, but the Act made various changes for investments beginning in 2027.

(1) Deferral of existing gain. The set deferral date (December 31, 2026 under the first program) was 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 was eliminated.

(3) Possible nonrecognition of gains in QOF investment. The nonrecognition provision was 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 restricted the definition of a "low-income community" (which is one of the categories of permissible qualified opportunity zone investments). In particular, the Act removed 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 was 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 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**.

v. **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 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 provided 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 receive no benefit from this measure; "it is more of a middle-income benefit, not a low-income benefit." Regulations are 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 are not 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 would 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 would be treated as a transition period for enforcement and administration of the new information reporting requirements for cash tips and qualified overtime compensation.

The Congressional Research Service estimated that 2.6 percent of households in 2026 will benefit from the tip provision, and that the provision will reduce federal revenues by $28.6 billion through fiscal year 2029. Brendan McDermott, *Taxation of Tip Income Under the 2025 Reconciliation Law,* Congressional Research Service (Jan. 21, 2026).

(2) **Deduction for Overtime Compensation.** The Act provided 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) The IRS has issued FAQs to address the qualified overtime compensation deduction. *IRS Fact Sheet* 2026-01 (Jan. 23, 2026). Treasury and IRS previously issued Notice 2025-62 providing penalty relief to employers and other payers for tax year 2025 regarding new information reporting requirements for qualified overtime compensation; and issued Notice 2025-69 for workers eligible to claim the deduction for overtime compensation for tax year 2025.

(3) **Deduction for Seniors.** The Act granted 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 was 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 allowed 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 track 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. The American Society of CPAs has recommended to the IRS that it issue guidance providing that transfers to Trump Accounts would be treated as present interest gifts.
- Because the accounts are treated under the traditional IRA rules after the minor reaches age 18, the account could be converted to a Roth account. (Notice 2025-68 specifically says the rules regarding "Roth conversions" will apply after the minor reaches age 18.) 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**.

The IRS and Treasury issued proposed rules, on March 6, 2026, describing various procedural issues. REG-117002-25 and REG 117270-25.

Michael and Susan Dell 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. Various companies have pledged to make contributions to Trump accounts for their employees.

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; Trust and UTMA 529 Accounts.** 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 made significant helpful enhancements for 529 accounts: (1) the list of eligible education expenses was 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) was increased from $10,000 to $20,000 (applicable for tax years after 2025); and (3) "qualified postsecondary credentialing expenses" were added as exempt distributions (applicable for distributions after the date of enactment).

Some clients are asking about having a trust establish a 529 account for a beneficiary. A trust can create separate 529 plans for trust beneficiaries (meaning that the trust would avoid income taxation on the growth within the 529 account). The trust would be the owner and would have the authority to change the beneficiary once a particular trust beneficiary no longer needed educational expenses.

The Uniform Transfers to Minors Act will be revised in the summer of 2026 to allow the custodian of a UTMA account to fund a 529 account.

(8) **Increased Excise Tax on Colleges and Universities.** The Act increased 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 are: 1.4% ($500,000-$749,999), 4% ($750,000-$1,999,999), 8% (over $2,000,000). The 8% rate applies 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 applies 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 expanded 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 in 2026. Yale's president indicated that Yale would pay about $280 million in 2026. The American Enterprise Institute estimates that the endowment tax in 2026 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 four 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 did not include a provision for adding a new higher income tax bracket for high-income taxpayers (which had been suggested by President Trump), did not tax "carried interests," and did not include provisions limiting the amortization of intangible assets of sports franchises (which was in the House version).

w. **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 were 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 were not updated for 2025, (2) income tax withholding tables were not updated, and (3) employers and payroll providers continued using existing 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 included some tax decreases beginning in 2025 (mentioned above). Joseph Rosenberg, a senior fellow with the Urban Institute-Brookings Institution Tax Policy Center estimated 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/**.

42. APPENDIX CONTINUATION – Behind the Scenes: Background Issues of Primary Importance in the Evolution of the Act

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**.

b. **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 held a majority of both the House and Senate in 2025 and passed the Act without bipartisan involvement. (Congress could pass another reconciliation act in 2026 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.

c. **"Byrd Rule" Overview.** The "Byrd Rule" applies in the Senate for reconciliation acts. A Senator can make a 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).

d. **Brief History of Adoption; Revenue Costs; National Debt.** For a discussion of a brief history of the adoption of the Act, costs and dynamic revenue effects of the Act, and impact on the national debt and federal interest payments, see Item 5.c-e of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

e. **Current Policy Baseline; Byrd Rule.** 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). For a summary of the history of the development of the Act using the current policy baseline, see Item 5.f of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

   The current policy baseline approach seems to violate the spirit of the Byrd Rule, one provision of which is that the act cannot increase deficits outside the budget window. That is the reason that major tax legislation passed under the reconciliation process has historically "sunsetted" after the end of the budget window. How was this approach determined to be permissible under the Byrd Rule? The chair of the Senate never presented the issue to the Parliamentarian, and the Senate simply voted by majority vote that the Act did not violate the Byrd Rule. For a detailed discussion of

that history, including excerpts of dialogue from the Congressional Record, see Item 5.g of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

f. **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 as effectively emasculating 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 (by majority vote).

> 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.")

g. **Cuts to Medicaid, Affordable Care Act, and Nutrition Programs.** The Act made substantial cuts to Medicaid, payments under the Affordable Care Act, and to nutrition programs, some of which have been controversial. For a summary of those changes, see Item 5.i and j of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

h. **SALT Deduction Cap Compromise; Political Realities; Investors Influence.** 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).

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. 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."

Investors (and in particular, the bond market) may eventually force Congress to address growing national deficits. "Bond vigilantes" have forced policy changes in the past. See Item 5.m of LOOKING AHEAD – Estate Planning in 2025, Current Developments & Hot Topics (Dec. 31, 2025), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.