LOOKING AHEAD – Estate Planning in 2026 & Current Developments

August 2026

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August 24, 2026

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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.
- The subsequent items discuss various current developments, IRS rulings, and cases.

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 99.9% 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). *See* Center on Budget and Policy Priorities, *The Federal Estate Tax* (Dec. 19, 2025) (the 2017 tax law that increased the exemption from $5 million indexed to $10 million indexed resulted in the share of estates facing estate tax to fall from 2 in 1,000 to under 1 in 1,000). 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 for 2026?** 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).

The first Trump administration passed the 2017 tax act (commonly referred to as the Tax Cuts and Jobs Act). In the second Trump administration, OBBBA was passed in the summer of 2025 (for FY 2025), and the 2026 Secure America Act was enacted on June 10, 2026 (for FY 2026). A second reconciliation act in 2026 (for FY 2027) has been discussed for things that might include 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).

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. **The Taxpayer Assistance and Service Act, S. 3931.** The Taxpayer Assistance and Service Act is a bipartisan federal tax administration bill that was approved by the Senate Finance Committee by a 26-1 vote (the sole no-vote was from Sen. Elizabeth Warren, who favors the bill but objected because a proposed Democratic amendment to bar the Treasury and IRS from entering into agreements affecting tax matters of the President, his family, or related entities was not included). The Act would automate many audit and service activities for low-income compliance matters, leaving more resources for more complex, higher dollar cases.

Section 101 of the Act makes electronic filing broadly available and requires electronically filed returns to be processed electronically. It does not require returns be filed electronically, but it does require that certain returns be digitized. Electronically filed returns will be processed electronically, and paper returns will be digitized using OCR technology (unless the OCR technology is determined to be slower or less reliable than manual transcription or other IRS processes). It requires that estate and gift tax returns received on or after January 1 of the first calendar year beginning more than 24 months after date of enactment be digitized. One commentator summarizes the anticipated effect:

> Once these returns are digitized and machine-readable, AI-based pattern-matching and automated issue identification become possible at scale. This likely means that valuation discounts, special-use valuations, and complex trust structures will be algorithmically flagged rather than manually spotted.

Alan Gassman & Shawn Carey, *S. 3931: The Taxpayer Assistance and Service Act – Analysis for Estate and Tax Planning Practitioners*, LEIMBERG INCOME TAX PLANNING NEWSLETTER #298 (Aug. 10, 2026).

f. **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).

g. **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 to the combined Social Security fund. The bill has no chance of progressing in the current Congress. For a discussion about and planning implications of the proposal, see Kerry Ryan, *The Strengthen Social Security by Taxing Dynastic Wealth Act: Throwback or 'Fauxback'?*, 192 TAX NOTES FEDL. 283 (July 13, 2026)..

h. **Proposal to Tax Trusts Over $50 Million.** Senators Patty Murray (D-WA) and Ron Wyden (D-OR) have proposed the Fair Trusts for Fiscal Responsibility Act of 2026. Among other things, it would create a new annual withholding system for trusts: 1% on assets between $50 and $100 million; 1.5% on assets between $100 and $250 million; 2% on assets between $250 million and $1billion; and 3% on assets above $1 billion. The press release announcing the proposal says that fewer than 0.1% of American pay estate tax at all, but the very wealthiest American use special trusts to "delay, minimize, and avoid paying their fair share. Financial Planners flaunt their ability to circumvent taxes and specifically advertise these trusts, providing detailed examples to attract wealthy clients." The release states that GRATs have been estimated to cost the federal government more than $100 billion between 2000-2013 and that "hundreds of billions of dollars and potentially trillions of dollars are held in generation-skipping transfer tax exempt trusts that are not subject to the rule against perpetuities." It summarizes that "Congress needs a solution that goes beyond targeting individual loopholes—a solution that weakens transfer tax avoidance schemes across the board by requiring annual, upfront payment." For an overview of the proposal and planning implications, see Thomas Tietz & Martin Shenkman, *Fair Trusts for Fiscal Responsibility Act of 2026: A Technical Reassessment of Large-Trust Planning*, LEIMBERG ESTATE PLANNING NEWSLETTER #3310 (July 1, 2026).

i. **National Debt, Deficits, Bond Market Pressures.** The federal fiscal picture continues to deteriorate. In August 2026, the gross federal debt—Treasury's "Total Public Debt Outstanding"—crossed $40 trillion for the first time (the $40 trillion figure includes both debt held by the public and intragovernmental holdings). U.S. Treasury, Fiscal Data Debt to the Penny (Aug. 20, 2026) available at **https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-penny**. The annual budget deficit is running at approximately $2 trillion: CBO's February 2026 baseline projected a fiscal 2026 deficit of $1.9 trillion, and its latest monthly report estimates that the deficit had already reached $1.8 trillion during the first ten months of fiscal 2026. Perhaps even more striking, the federal government now spends more servicing its existing debt than it spends on national defense. CBO projects approximately $1.0 trillion of net interest outlays in fiscal 2026, compared with approximately $918 billion of total defense outlays; GAO likewise reports that net interest spending of $970 billion in fiscal 2025 exceeded national-defense spending. These trends may eventually cause the bond market to impose a degree of fiscal discipline that the political process has thus far been unable to impose. As Treasury must continually issue additional debt to finance large deficits and refinance maturing obligations, investors may demand higher yields to absorb that debt; higher rates, in turn, increase federal interest costs and produce still larger deficits. CBO specifically warns that large and rising federal debt increases economy-wide borrowing costs, makes the budget increasingly vulnerable to higher interest rates, and raises the risk of a fiscal crisis in which investors lose confidence in Treasury debt and interest rates rise abruptly. That possibility is not entirely theoretical: longer-term Treasury yields have risen substantially during 2026 amid concerns that include inflation, continuing large deficits, and the growing federal debt; on August 24, the 10-year Treasury yield was approximately 4.7%, while the 30-year yield had recently reached its highest level since 2007.

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

- For more detailed summaries of select tax provisions in and developmental history of the One Big Beautiful Bill Act (OBBBA), see the Appendices in LOOKING AHEAD – Estate Planning in 2026 & Current Developments (Including Observations from Heckerling 2026) (June 1, 2026) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

a. **Bluebook from Joint Committee on Taxation.** The Joint Committee on Taxation released the "General Explanation of Tax Provisions of Public Law 119-21," commonly referred to as the "Bluebook," on May 28, 2026. The Bluebook makes various recommendations for technical corrections. It also includes estimated budgetary impacts of the legislation determined relative to "the present law Congressional Budget Office 2025 macroeconomic forecast."

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. The Bluebook estimates that the extension and enhancement of the estate and gift tax emption amounts will cost $211.725 billion from 2025-2034 (really just over nine years because there was minimal impact in FY 2025).

d. **Application of the 2/37ths Reduction Under §68 to Trusts and Estates.**

(1) **Overview.** 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).

(2) **Bluebook Footnote 102.**

The Joint Committee on Taxation's "General Explanation of the Tax Provisions of Public Law 119-21" (commonly referred to as the Bluebook) was published May 28, 2026. Its footnote 102 has aroused concern among many. What's the story behind the footnote and this consternation? (Public Law 119-21 is the formal title of what is commonly referred to at the One Big Beautiful Bill Act (the "Act").)

Section 11 of Chapter 1 of the Bluebook discusses new §68, which replaces the old "Pease limitation" and generally gives taxpayers in the top 37% income tax bracket only a 35% benefit from itemized deductions. The explanation of §68 in the Bluebook begins by saying it "repeals the Pease limitation and provides a limitation on the tax benefit of an individual's itemized deductions," but drops footnote 102 to that initial sentence explaining that §68 also applies to trusts and estates.

> [102] The provision also applies to estates and trusts. See sec. 641(b) (providing that the taxable income of an estate or trust generally is computed in the same manner as in the case of an individual). Section 63(d) defines the term "itemized deductions" to refer to all allowable deductions other than those allowable in arriving at adjusted gross income, see sec. 62 and those listed in section 63(b). Therefore, the itemized deductions for an estate or trust include (without limitation) the personal exemption under section 642(b) and the deductions for beneficiary distributions under sections 651 and 661. Treasury Regulation section 1.67-4(a)(1)(ii) provides that these three deductions "are not itemized deductions under section 63(d)." That regulation, however, interprets section 67(e), which provides, "For purposes of this section [which, for certain taxable years, imposed a limitation on miscellaneous itemized deductions]," the section 642(b), 651, and 661 deductions are treated as allowable in arriving at adjusted gross income. Because the rule of section 67(e) is, by its terms, limited to section 67, the regulation does not exclude the deductions under section 642(b), 651, or 661, or any other deductions, from being itemized deductions for purposes of the provision.

Joint Committee on Taxation, *General Explanation of the Tax Provisions of Public Law 119-21*, at 26 (May 2026).

The background of this footnote is outlined below with a journey through various Code sections and a regulation. But the bottom line impact is that the Bluebook interprets §68 as applying to the income tax deductions for trusts and estates.

(3) **Many Itemized Deductions Are No Longer Deductible**. Section 67(h) says that "no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017." The term "miscellaneous itemized deductions" means all itemized deductions other than certain specifically listed deductions (in §67(b) and §67(e)).

Rather than listing certain deductions applicable to estates and trusts in the list in §67(b), §67(e) says that, for purposes of §67, unique trust and estate expenses (incurred solely because property was held in an estate or trust), the personal exemption under §642(b), and distribution deductions under §651 or §661 "shall be treated as allowable in arriving at adjusted gross income." If those trust and estate deductions are treated as allowable in arriving at adjusted gross income, they are not itemized deductions and therefore are not miscellaneous itemized deductions under §67.

(4) **Itemized Deductions That Are Allowable Are Subject to §68 "In the Case of an Individual."** Section 68 limits taxpayers in the top 37% income tax bracket to only a 35% benefit from "itemized deductions." A gross oversimplification of §68 is that it reduces itemized deductions by 2/37ths (about 5.4%) for taxpayers in the top income tax bracket. But §68 begins with "[i]n the case of an individual." So how does it apply to trusts and estates? (OBBBA repealed the prior §68(e), which said that §68 (the prior Pease limitation) did not apply to estates and trusts.)

(5) **Section 641(b) Definition of Taxable Income of Trusts and Estates**. Section 641(b) says "[t]he taxable income of 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." (It is probably not a mere coincidence that both §68 and §641(b) use the phrase "in the case of an individual.")

(6) **"Itemized Deductions," §63(d)**. Section 68 applies the 2/37ths reduction to "itemized deductions." Section 63(d) defines "itemized deductions" as "the deductions allowable under this chapter [Chapter 1 of Subtitle A, "normal" income taxes including income taxes for individuals, estates and trusts] other than deductions allowable in arriving at adjusted gross income (generally, those listed in §62) and certain deductions listed in §63(b) (that are allowable for individuals who do not itemize their deductions).

(7) **Section 67(e) Might Suggest That Unique Trust Deductions, the Personal Exemption, and Distribution Deductions Are Not Itemized Deductions**. Section 67(e) says that the deduction for unique trust expenses, the personal exemption (§642(b)), and the distribution deduction (§651 and §661) "shall be treated as allowable in arriving at adjusted gross income." That sounds like those deductions are therefore not itemized deductions and therefore are not subject to §68. But …

(8) **Regulation Under §67 Says Those Deductions Are Not Itemized Deductions**. Treas. Reg. §1.67-4(a)(1)(ii) says that §67(e) deductions (unique trust expenses, the personal exemption, and distribution deductions) "are not itemized deductions under section 63(d)." Great—again, this is another indication that those deductions for estates and trusts are not itemized deductions and therefore are not subject to §68. But …

(9) **BUT, Five Little Words**. Section 67(e) begins with "For purposes of this section." That is §67, not other sections of the Code and not §68. Therefore, the statement in §67(e) that those trust deductions are allowable in arriving at adjusted gross income (and therefore are not itemized deductions) and the statement in the regulation that those trust deductions "are not itemized deductions" do not apply for purposes of §68. That is the background behind the statement in footnote 102 of the Bluebook that the regulation "does not exclude the deductions under section 642(b), 651, or 661, or any other deductions, from being itemized deductions for purposes of the provision." So, the general rule of §63(d), which would treat those deductions as "itemized deductions," applies for purposes of §68.

(10) **Furthermore, Repeal of Prior §68(e)**. The prior §68, which described the now discarded Pease limitation, excluded estates and trusts from its operation in §68(e). The repeal of §68(e), which was included in every version of the proposed bill, suggests Congressional intent that estates and trusts are subject to §68.

(11) **Furthermore, Senate Finance Committee Explanation**. In addition, the Senate Finance Committee's section-by-section summary of OBBBA, released after the date of enactment, said "that provision permanently repeals the Pease limitation and replaces it with a new overall limitation on the tax benefit of itemized deductions, applicable to individuals, estates, and trusts."

(12) **Application of §68 to Distribution Deductions Can Result in DOUBLE TAXATION for About 5.4% of Income of Estates and Trusts**. Footnote 102 of the Bluebook specifically mentions that §68 applies to the distribution deductions under §651 and §661. Distributions carry out the income of trusts and estates to the recipient beneficiaries (to the extent of DNI); the beneficiaries pay income tax on those amounts but not the trust or estate because of the distribution deduction. If the distribution deduction is reduced by 5.4%, double taxation can result to the extent of about 5.4% of the income of trusts and estates.

There is absolutely no policy rationale to support that result. It was a technical drafting mistake, and the Bluebook surprisingly does not suggest that a technical correction is needed to fix this drafting mistake.

If the distribution deduction must be reduced by 5.4%, a planning alternative may be to favor loans to beneficiaries rather than making distributions to avoid the double tax on 5.4% of income that would result from making distributions that carry out income to beneficiaries.

(13) **IRS Guidance May Provide Relief**. Fiduciaries who file their 2026 fiduciary income tax returns on April 15, 2027, will have to decide whether to reduce the claimed distribution deduction by 5.4%. Hopefully, the IRS will provide specific guidance to fiduciaries regarding the distribution deduction in particular. The guidance may come in the Instructions for 2026 Form 1041. (This issue is not on the Treasury-IRS Priority Guidance Plan for 2026.)

The IRS conceivably could issue guidance (possibly in instructions to the Form 1041 for 2026) providing that distribution deductions under §651 and §661 are viewed for §68 purposes not as deductions but as allocations of income, so the 5.4% reduction of itemized deductions under §68 would not apply to distribution deductions of trusts and estates.

A statutory rationale for this position is that §641(b) says the same income tax rules apply to trusts and estates as for individuals **"except as otherwise provided in this part."** Accordingly, a possible argument is that §68, which applies "in the case of an individual," applies only to estate and trust deductions that are treated "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.

Indeed, there are informal indications from Treasury staff that Treasury anticipates issuing guidance that §68 does not apply to trusts.

(14) **Computation Complexities**. Applying §68 to the distribution deduction will result in a circular computation in some situations. The provisions of §68 attempt to avoid the necessity of circular calculations 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 for a trust that requires the distribution of all fiduciary accounting income (such as a QTIP trust) may result in a circular calculation (unless the resulting income tax is charged against principal or unless a principal distribution is made to the spouse in an amount equal to the income tax).

For example, assume a QTIP trust has $1M of ordinary income (so there is no issue of capital gains taxes, which would not be charged against income). The income tax that the trust must pay as a result of reducing the distribution deduction by 5.4% is a charge against fiduciary accounting income (e.g., UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT §506(a) (2018)) and presumably will offset the amount required to be distributed. But when that is subtracted, $1M is no longer distributed, so the distribution deduction will be lower, meaning more income tax. That is a further charge against income, further reducing the amount of accounting income to be distributed, resulting in an even lower income distribution, an even lower distribution deduction, and more income tax. A circular computation results. If a trust has ordinary income of $1 million, reducing the distribution deduction by 5.4%, the first iteration would result in an income tax of 37% x ($1M – [$1M - (5.4% x $1M)]), or 37% x $54,000, or $19,980. But the income distribution would be reduced by $19,980, resulting in a lower distribution deduction and a higher tax. The 11th iteration results in a final tax of $30,739, or about 54% more than the initial $19,980 amount. The trust would distribute $969,261 to the income beneficiary and would be left with the remaining $30,739 of the $1 million of income to pay the income tax.

For a situation in which assets pass under a will to a revocable trust, which in turn passes to an administrative trust, which passes to a QTIP trust, and which may be distributed to a surviving spouse beneficiary, would the 5.4% reduction in the distribution deduction be applied at each of those levels, increasing the income taxes at each level?

This complexity presents fiduciary decisions for the trustee. If all of the income is distributed, the trust may have insufficient liquidity to pay the income tax. If the trustee reserves funds to pay the income tax, income beneficiaries may object. If the tax is charged against principal, the remainder beneficiaries may object. State law may permit equitable adjustments to allocate funds between income and principal to achieve fairness. *E.g.*, *Matter of Warms*, 140 NYS 2d 169 (Surr. Ct. 1955). The trustee might be able to exercise the power to adjust between income and principal. *See* UNIF. FIDUCIARY INCOME AND PRINCIPAL ACT §203 (2018); UNIF. PRINCIPAL AND INCOME ACT §104 (1977).

Some states do not apply the 2/37ths reduction to itemized deductions, leading to differences in the computations for federal and state income tax purposes.

Another complexity is that the §691(c) deduction, generally designed to avoid subjecting an income in respect of a decedent asset to both the federal estate tax and the federal income tax, is also an itemized deduction and may be subject to the 5.4% reduction under §68.

For an excellent discussion of the complexities of applying the §68 2/37ths reduction to trust-related deductions, see Robert Keebler, Martin Shenkman & Jonathan Blattmachr, *Estate & Trust Planning Under Section 68 and the Emerging 2.37 Limitation – An Alice and Wonderful Trip Through the UPIA, UTC and Equitable Adjustments*, LEIMBERG EST. PL. NEWSLETTER #3311 (July 07, 2026).

(15) **Charitable Deduction, §642(c)**. The charitable deduction for trusts and estates under §642(c) is clearly an itemized deduction, and therefore presumably subject to §68. The Bluebook did not mention §642(c) at all (including in its discussion of the application of §68 to estates and trusts).

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)? Charitable planning experts generally believe that the "without limitation" phrase in §642(c) was included specifically to make inapplicable the percentage limitations of §170, not to override other generally applicable statutory restrictions.

If §68 applies to the §642(c) deduction, a circular calculation may be needed. For example, for an estate passing entirely to charity, a circular calculation will 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. 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). However, under the peculiar facts of *Hartwick College*, if the income tax had been subtracted from the charitable deduction, **no** amount would have passed to charity. In a more typical situation, where the entire charitable transfer would not be eliminated, a court might not be as persuaded to find a way to avoid the circular computation analysis and the charitable deduction would be allowed only for the amount actually passing to charity (after the estate pays its income tax).

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.

(16) **Resource**. For an excellent article discussing the application of §68 to trust deductions, see Justin Miller, *The Fate of a Trust or Estate Under New Section 68*, 191 TAX NOTES FEDL. 1727 (June 8, 2026). For further 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 14 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).

Trump account investment options are discussed in Item 9.g below.

Contributions to Trump accounts are not treated as "present interest" gifts qualifying for the gift tax annual exclusion under the statute. The Bluebook does not discuss the availability of the gift tax exclusion for contributions to Trump accounts and does not recommend a technical correction about that issue. However, Rev. Proc. 26-25 states that cash gifts to Trump accounts by individuals will be treated as present interest gifts qualifying for the annual exclusion in certain circumstances. See Item 9.f below.

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 were 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 more than 99.9% of the population will have no estate tax concerns but, nevertheless, 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. Commissioner*, 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 v. Commissioner*, 2026 WL 1642415 (5th Cir. June 8, 2026), *aff'g*, T.C. Memo 2024-90 (discussed in Item 28 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**.

9. Miscellaneous Guidance From IRS (Including Gift Reporting for Trump Accounts); 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.

f. **Gift Tax Return Reporting for Trump Accounts**. Contributions to Trump accounts are not treated as "present interest" gifts qualifying for the gift tax annual exclusion under the statute. The Bluebook does not discuss the availability of the gift tax exclusion for contributions to Trump accounts and does not recommend a technical correction about that issue. However, Rev. Proc. 2026-25 provides a safe harbor under which cash gifts to Trump accounts by individuals will be treated as present interest gifts qualifying for the annual exclusion if five requirements are satisfied.

Rev. Proc. 2026-25 does not offer a rationale for any statutory analysis supporting its safe harbor position. Instead, it observes that (1) for donors, "the cost and other burdens of complying with gift tax reporting requirements could outweigh the anticipated financial savings benefit" of contributing to a Trump account, and (2) for the IRS, the safe harbor prevents a dramatically increased burden of processing gift returns (potentially increasing from 300,000 per year to millions per year).

(1) **Five Safe Harbor Requirements.** The five requirements of the safe harbor are:

(1) Taxpayer is an individual.

(2) The only taxable gifts made by the taxpayer during the calendar year are cash contributions (in the form of cash, check, money order, or electronic funds transfer) to one or more Trump accounts, each made before the calendar year in which the account beneficiary attains age 18;

(3) The taxpayer's total gifts during the calendar year to each individual who is an account beneficiary, including contributions to that account beneficiary's Trump account, do not exceed the annual exclusion amount under section 2503(b) ($19,000 for 2026);

(4) Such contributions to Trump accounts made during the calendar year do not generate for that calendar year either a gift or GST tax liability, after application of the taxpayer's remaining applicable credit amount against the gift tax, or remaining GST exemption; and

(5) Disregarding the Trump account contributions described in section 4.02(2) of this revenue procedure, no gift tax return is required to be filed, and no gift tax return is otherwise filed, for that calendar year by or on behalf of the taxpayer, whether for GST tax, portability, or other purposes.

(2) **Observations.**

(a) **Certain Non-Cash Gifts Are Allowed.** Under the safe harbor, the donor can make non-cash gifts that qualify for the marital or charitable deduction or that qualify for the annual exclusion (but not contributions to Trump Accounts). Requirement (2) says that the only "taxable gifts" during the year are cash contributions to Trump accounts. "Taxable" gifts do not include gifts that qualify for the gift tax marital or charitable deductions (§2503(a)) or the annual exclusion (§2503(b)(1)).

(b) **Trump Account Contributions Count Against Applicable Exclusion Amount (AEA) If Total Gifts to the Account Beneficiary Exceed Annual Exclusion Amount.** If Trump account contributions plus other gifts to the account beneficiary exceed the annual exclusion for the year, the safe harbor is not satisfied, so the Trump account contribution must be reported on a gift tax return, and the amount of the total gifts to the beneficiary during that year (including the Trump account contribution) in excess of the annual exclusion amount will reduce the lifetime AEA (or will result in the payment of gift tax if the cumulative lifetime taxable gifts exceed the AEA).

(c) **Requirement 4 Ambiguity.** Requirement 4 is confusing. If total gifts to the account beneficiary during the year (including Trump account contributions) do not exceed the annual exclusion amount (Requirement 3), how could "such contributions to Trump accounts" ever generate a gift tax liability? Understandably, such a Trump account contribution could conceivably generate a GST tax liability if the contribution is made to an account for a grandchild of the contributor; the direct skip may not qualify for the nontaxable gift exception under §2642(c)(1) if the account is treated as a trust equivalent under §2652(b). Such direct skip gift would generate a GST tax liability if the transferor did not have sufficient unallocated GST exemption to cover the Trump account contribution.

Perhaps Requirement 4 should be interpreted to mean "Such contributions to Trump accounts made during the calendar year **would** not generate for that calendar year either a gift or GST tax liability, after application of the taxpayer's remaining applicable credit amount against the gift tax, or remaining GST exemption, **if the gifts to Trump accounts are not treated as present interest gifts.**"

(d) **Gift Tax Return Not Filed.** If a gift tax return for the year of the Trump account contribution is filed for any reason (for example, to report some non-gift transaction to start the gift tax statute of limitations on that transaction), the safe harbor does not apply (Requirement 5). The Trump account contributions are not present interest gifts, must be reported on the gift tax return, and will utilize some of the donor's AEA.

g. **Trump Account Investment Options; Guidance Regarding Employer Contributions.** Notice 2025-68 and subsequent proposed regulations (REG-117002-25 and REG-117270-25) state generally that Trump accounts must be invested in a mutual fund or ETF that tracks the returns of the S&P 500 stock market index or other index comprised of equity investments in primarily U.S. companies and that meets certain requirements (including that annual fees are not more than 0.1 percent). Treasury announced on July 1, 2026, that at launch, all contributions to Trump accounts will be invested in the State Street SPDR Portfolio S&P 500 ETF (SPYM) exchange traded fund. Four other low-cost index fund options are iShares Core S&P 500 ETF (IVV), Vanguard Total Stock Market ETF (VTI), State Street SPDR Portfolio S&P 1500 Composite Stock Market ETF (SPTM), and iShares Core S&P Total U.S. Stock Market ETF (ITOT). On Aug. 20, 2026, the IRS issued detailed guidance regarding eligible investments for Trump Accounts. RIN 1545-BS14.

Treasury announced on July 2, 2026, that it would accept large philanthropic donations of readily tradable public stocks as contributions to Trump accounts.

Proposed regulations (REG-101355-26) were issued on Aug. 11, 2026, covering employer contributions to Trump accounts (if allowed by a written plan) and providing nondiscrimination testing rules for both Trump Account contribution programs and dependent care assistance programs. An employer may contribute up to $2,500 per year tax-free to a Trump account for the employee's dependents. Also, employees can make a pre-tax salary-reduction contribution to a dependent's

Trump account, but that does not create a second $2,500 exclusion. The $2,500 annual limit applies to the combined §128 contributions with respect to the employee, including both employer-funded contributions and employee salary-reduction contributions through a §125 cafeteria plan. For example, if the employer contributes $1,000, the employee could elect up to $1,500 of salary reduction, assuming the employer's plan permits it; if the employer makes no contribution, the employee could potentially fund the entire $2,500 through salary reduction to a dependent's Trump account. The employee could also make other after-tax contributions to Trump accounts, up to the $5,000 aggregate contribution limit for any particular Trump account. (These amounts are indexed for inflation after 2027.) The $2,500 cap applies per employee, not per dependent, so an employee with more than one child does not get multiple $2,500 exclusions.

If an employer's contributions do not satisfy the nondiscrimination test, amounts contributed for "highly-compensated employees" will not be tax-free to those employees. For an overview of the nondiscrimination tests under the proposed regulations, see Trevor Sikes, *New Trump Account Guidance Tackles Nondiscrimination Confusion*, 196 TAX NOTES FEDERAL 1316 (Aug. 17, 2026).

h. **QDOT Final Regulations.** Final regulations were issued July 6, 2026, finalizing proposed regulations published in August 2024 making various administrative changes to the QDOT regulations. The regulations remove obsolete references, update IRS office names and administrative procedures, revise the definition of when an estate tax liability is "finally determined" by eliminating references to estate tax closing letters, and clarify that references to the Estate Tax Advisory Group include successor offices. The regulations do not make substantive changes to the QDOT requirements. Because the changes are merely administrative in nature, the regulations are effective July 10, 2026, rather than applying only to estates of decedents who die on or after that date.

i. **Abusive CRATs Treated as Listed Transactions.** Certain abusive charitable remainder annuity trust (CRAT) transactions are identified as listed transactions (for purposes of Reg. §1.6011-15 and § 6111 and §6112) in final regulations (T.D. 10051) issued on July 8, 2026. The regulations formalize how certain CRAT transactions and substantially similar transactions will be designated as listed transactions and added details to Reg. §1.6011-15 characterizing a transaction involving a purported CRAT as a listed transaction if (1) the grantor created a trust under §664(d)(1), (2) the grantor funds the trust with property having a fair market value that exceeds its basis, (3) the trustee sells that property, (the trustee uses some or all of the proceeds to purchase an annuity, and (5) the beneficiary of the trust treats the annuity payable as if it were an annuity payment governed by §72. *See* Richard Fox, *Final Regulations Designating Certain CRAT Arrangements as Listed Transactions – The IRS's Latest Step in Campaign Against Promoted CRAT/SPIA Tax Avoidance Arrangements*, LEIMBERG CHARITABLE PLANNING NEWSLETTER #369 (July 13, 2026).

Listed transactions must be reported to the Office of Tax Shelter Analysis (OTSA) on Form 8886 within 90 days after a transaction becomes a listed transaction (Reg. §1.6011-4(e)(2)(i)); the relevant 90-day due date is Oct. 7, 2026 for this new listed transaction. The Oct. 7 deadline will apply to a taxpayer who previously filed a return before July 9, 2026, reflecting participation in the described CRAT arrangement and the assessment period for a taxable year of participation had not expired when the transaction became listed.

10. Basis Consistency Final Regulations; Revised Form 8971

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 (these reports are made on Form 8971). 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).

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, including very detailed comments from ACTEC. 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). In particular, three issues in the proposed regulations were highly criticized by planners, and the IRS reversed course as to all three of those issues in the final regulations: (1) reporting of undistributed property; (2) removal of the zero basis rule for unreported property; and (3) eliminating the subsequent transfer reporting requirement for all beneficiaries other than trustees.

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). For a summary of the changes in the final regulations see Item 4 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.**

b. **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 would not enforce any penalties or fines on U.S. citizens or domestic reporting companies or their beneficial owners, and it would narrow the scope of the rule for reporting beneficial ownership information (BOI) to foreign reporting companies only. Interim final rules were issued March 26, 2025, and final rules were issued Aug. 11, 2026, effective Aug. 14, 2026 (RIN 1506-AB67).

- The definition of a reporting company is changed to mean only entities that are formed under foreign law and have registered to do business in any U.S. state or Tribal jurisdiction.
- Domestic reporting companies are exempted from any BOI reporting requirements.
- If a foreign entity creates a U.S. subsidiary to do domestic business, there would be no requirement to report beneficial ownership information (BOI) of any U.S. person who is a beneficial owner or company applicant of the foreign reporting company.
- Foreign companies owned by U.S. citizens do not have to report.
- U.S. persons do not have to provide BOI information to a reporting company for which the U.S. person is a beneficial owner or company applicant (exemptions for company applicants were added in the final rules; they were not exempt under the interim final rules).
- The preamble to the final rules states that FinCEN is implementing a process to delete information about any individuals – company applicants, beneficial owners, or recipients of a FinCEN ID – that FinCEN reasonably believes was provided by a U.S. person.
- New BOI reporting deadlines for foreign companies are specified. The interim final rules required that reporting companies registered to do business in the U.S. before the date of publication of the interim final rules in the Federal Register would 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. The final rules are effective Aug. 14, 2026, and the reporting requirements under the interim final rules remain in effect.
- Foreign pooled investment vehicles do not have to report BOI for any U.S. person who exercises substantial control over the entity.
- The requirement for any U.S. person to update or correct information that the U.S. person provided in order to obtain a FinCEN ID, whether as beneficial owner or company applicant, is eliminated.
- In the March 2025 interim final rules, FinCEN estimated that approximately 11,667 reporting companies would be subject to the narrowed regime per year on average, compared with approximately 32.6 million companies estimated to be subject to the original reporting requirements. In the August 2026 final rules, FinCEN updated its estimates based on more recent data, estimating an existing population of approximately 28,000 non-exempt foreign reporting companies, approximately 13,000 of which had already filed BOI reports by the end of 2025. FinCEN estimates that approximately 15,000 existing companies remain to file and that approximately 1,800 newly registered foreign reporting companies will become subject to the requirements annually. For Paperwork Reduction Act purposes, FinCEN estimates an average of approximately 6,800 initial BOI reports per year over the first three years following the final rules.

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. **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.**

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**.

14. 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.)

Married spouses filing separately are each entitled to only one-half the $15 million dollar-cap on the exclusion. §1202(b)(3)(A)(iii). (If only one spouse owns and sells the QSBS and the spouses file separately, the selling-spouse's flat dollar cap should be only $7.5 million and should not include any of the other spouse's unused amount.) For married spouses filing jointly, some planners take the position that each spouse gets a separate $15 million dollar cap. Reasons supporting this position are (i) the absence of any joint return reduction rule (Congress knew how to reduce the cap for married taxpayers and did so expressly only for separate returns), (ii) the per taxpayer wording in §1202 (and each spouse is a separate taxpayer even though they file a joint return), (iii) §1202(b)(3)(B) says that, in the case of a joint return, gain under §1202(a) is allocated equally between the spouses for purposes of applying §1202 in later taxable years, and that presupposes that each spouse has a separate §1202 "account" of limitation history or there would be no need to allocate gain between the spouse for subsequent-year purposes, and (iv) regulations state that "[a]lthough there are two taxpayers on a joint return, there is only one taxable income," Reg. §1.6013-4(b). *See* Paul Lee, *Scratching the 7-Year Itch: Quantum QSBS Exclusions*, 60th ANN. HECKERLING INST. ON EST. PL., Ch. 3, at p. 3-27 (2026). Other planners take the "one shared cap" position even for spouses that file joint returns. *See* Arielle Lederman & Heather Casteel, *Qualified Small Business Stock: Gray Areas in Estate Planning* (April 1, 2024) ("Anecdotally, a majority of tax advisers believe that while the answer may be unclear, the more conservative p\approach is that spouses are eligible for one aggregate QSBS exclusion ,,,, regardless of whether they file jointly or separately.").

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).

The Treasury assistant secretary for tax policy, Kenneth Kies, has stated that the department is working on guidance to address stacking abuse, particularly using multiple trusts.

> Kies said investors are going beyond setting up one trust per family member. The department is taking a "close look at" scenarios where investors have transferred stock through multiple trusts with several combinations of beneficiaries to maximize the tax break.
>
> "They're setting up other trusts. So you have three kids, A, B, and C, so A, B, and C trust. Then you set up an AB trust. Then you set up a BC trust, and so on, and so on," he said. "It's something we're taking a close look at."

Caitlin Reilly & Ben Steverman, *Popular Silicon Valley Tax Strategy Gets Warning From Treasury*, BLOOMBERG DAILY TAX REPORT (May 20, 2026). Trying to create seven different taxpayers for three children using trusts with differing primary beneficiaries (ABC, AB, BC, AC, A, B, and C) is suspect under §643(f), and the guidance may attempt to make that very clear.

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.

15. 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**.

16. Musings About Artificial Intelligence Issues for Estate Planners

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.

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.

The IRS Office of Professional Responsibility (OPR) on June 24, 2026 issued Alert 2026-19. It addresses confidentiality, responsibility for the accuracy of IRS filings, billing practices, competence and firm procedures, and review responsibilities before delivering AI content to clients. For planning considerations in view of that IRS Alert, see Shawn Carey, Martin Shenkman & Alan Gassman, *EstateViewAI and Co-Pilot: The IRS Weighed In, Introductory Guidelines for Responsible AI Use in Federal Tax Practice*, LEIMBERG ESTATE PLANNING NEWSLETTER #3321 (Aug. 3, 2026).

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.

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

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

a. ***Estate of Fields***. The latest reported case discussing the application of §20367 and §2043 to transfers to LPs and LLCs is *Estate of Fields v. Commissioner*, 2026 WL 1642415 (5th Cir. June 8, 2026), *aff'g*, T.C. Memo 2024-90, discussed in Item 27 below.

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%
Murphy (2009)	Securities/real estate	Fed. Dist.	41%
Pierre II	Securities	Tax	35.6%

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
(2010)			
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).

18. QTIP Trust Planning; Section 2519 and Gifts by Remainder Beneficiaries Consenting to Spouse Receiving All QTIP Assets, CCA 202118008; *Estate of Anenberg v. Commissioner*, 162 T.C. 199 (May 20, 2024); *McDougall v. Commissioner*, 163 T.C. 112 (Sept. 17, 2024); *Lewis v. Commissioner* & *McDougall v. Commissioner*, T.C. Memo. 2026-58 (July 20, 2026); 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. **CCA 202118008**. *McDougall* is the case (actually three consolidated cases) that was addressed in CCA 202118008 (family settlement under which all QTIP assets were distributed to the surviving spouse (H) who immediately gave and sold assets to trusts for descendants; IRS concluded that [1] two children (Children) who were the remainder beneficiaries made gifts of the remainder interest to H, [2] H made a gift of QTIP trust remainder interest under §2519, and [3] H used his estate and gift exclusion amount 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**.

c. **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.

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."

McDougall v. Commissioner, 163 T.C. 112 (Sept. 17, 2024) (majority opinion by J. Toro, concurring opinion by J. Halpern).

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).

d. **Cases Consolidated.** The three gift tax cases involving H and each of the two Children were consolidated for trial. *Bruce McDougall v. Commissioner*, Docket No. 2458-22 (all gift issues resolved regarding H and final order and decision entered January 30, 2025); Linda Lewis v. Commissioner, Docket No. 2459-22; Peter McDougall v. Commissioner, Docket No. 2460-22 (Petitions filed February 18, 2022, Judge Halpern). (The taxpayers are represented by John Porter, Keri Brown, and Tyler Murray.)

e. ***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; Post-Trial Briefs.** A one-and-a-half-day trial was held June 16-17, 2025, in Seattle, Washington. Post-trial briefs of the taxpayers and the IRS are summarized in Item 28.g of LOOKING AHEAD – Estate Planning in 2026 & Current Developments (Including Observations from Heckerling 2026) (June 1, 2026) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

g. **Brief Synopsis of *Lewis v. Commissioner, McDougall v. Commissioner,* T.C. Memo. 2026-58.** This opinion, resolving *Lewis v. Commissioner* and *McDougall v. Commissioner*, addresses the valuation of taxable gifts arising from the consensual termination of a QTIP trust. The opinion follows the Tax Court's earlier decision in *McDougall v. Commissioner*, 163 T.C. 112 (2024), which held that Linda Lewis and Peter McDougall made taxable gifts to their father, Bruce McDougall, when they signed a nonjudicial agreement stating that the trust "shall be commuted and the entire remaining balance of the Trust shall by distributed outright and free of trust to Bruce." The earlier opinion determined that the children made gifts but left the valuation of the gifts for later determination.

The Residuary Trust was created under the will of Clotilde McDougall, Bruce's wife and the mother of Linda and Peter (petitioners). Clotilde's estate consisted principally of her interest in a family real estate business. Bruce, as personal representative, made a QTIP election for the property funding the trust. Under the will, Bruce was entitled to the QTIP trust's net income for life and could receive principal, in the trustee's discretion, for his health, maintenance, and support in his accustomed manner of living. Bruce also held a limited testamentary power to appoint the trust property among Clotilde's descendants. In default of appointment, the remainder would pass in equal shares to Clotilde's children or their descendants.

Section 12.8 of Clotilde's will governed distributions upon the termination of any trust created under the will. Although the trustee was not required to make pro rata distributions, each distributee was required to receive property having a value equal to that distributee's interest in the trust at the time of distribution. On October 31, 2016, Linda, Peter, and Bruce entered into a nonjudicial agreement terminating the Residuary Trust and directing that its entire balance be distributed outright to Bruce. The parties stipulated that the trust assets were then worth $117,604,143.

The 2024 opinion held that Bruce did not make a gift under §2519 when the QTIP trust was terminated, because he received outright all of the trust property. The present opinion determines the values of the gifts made by Linda and Peter when they agreed that the QTIP trust would be terminated and all of its assets would be distributed to Bruce by valuing what Linda and Peter would have received if the beneficiaries had terminated the trust without directing all of its assets to Bruce. Under that hypothetical, §12.8 of Clotilde's will would have governed the allocation of the trust assets.

The parties' valuation positions differed substantially. The Commissioner initially asserted that each petitioner made a gift of $53,408,746, based principally on the actuarial tables prescribed under §7520. The petitioners maintained that, because Bruce had signed a will that would exercise his limited power of appointment in favor of his revocable trust, their remainder interests were worth only $156,000 each. Their expert also treated Bruce, who was 85 years old, as though he were 80 for life-expectancy purposes because of his high income and perceived good health.

The court rejected essential elements of both parties' analyses. The largest difference in the valuations by the parties turned on whether the gifts would be reduced because of Bruce's testamentary limited power of appointment. The Commissioner argued the power of appointment should be ignored because "the termination of the trust eliminated Bruce's limited power of appointment." The court rejected that reasoning but disregarded the power of appointment for another reason, based on its interpretation of Clotilde's intent under her will as to how trust assets would have been divided upon an early termination of the trust if the petitioners had not agreed that all the assets would pass to Bruce. It further held that the value of each petitioner's gift had to be reduced by the §2207A reimbursement obligation that each petitioner would have incurred if he or she had actually received a terminating distribution. The court also held that the valuation of income and remainder interests under §7520 did not control the allocation of trust assets because the beneficiaries' rights upon termination were determined initially under state law, and §7520 was not controlling for that purpose. Finally, the court rejected the petitioners' expert's decision to treat Bruce as five years younger than his actual age for purposes of determining the value of his income interest.

Because the Commissioner had conceded that each gift was worth no more than $35,141,321 if §2207A applied and §7520 did not control, the court held the Commissioner to that concession. Linda and Peter were each determined to have made a taxable gift of $35,141,321.

The petitioners resided in the state of Washington when they filed their petitions; therefore, any appeal will be to the Ninth Circuit Federal Court of Appeals. Petitioners no doubt will appeal this decision.

Lewis v. Commissioner, *McDougall v. Commissioner*, T.C. Memo. 2026-58 (July 20, 2026) (Judge Halpern).

h. **Court Analysis of Issues in *Lewis v. Commissioner, McDougall v. Commissioner*.**

(1) **Valuation Framework.** The court entered an Order on April 25, 2025, in response to the Commissioner's motion for partial summary judgment concerning the nature of the property that Linda and Peter transferred by gift. The Order treated the relevant property transferred by each petitioner as the right to receive the distribution that would have been made under §12.8 if the beneficiaries had agreed to terminate the Residuary Trust without specifying how the assets would be divided. The gift was therefore not valued simply as a marketable remainder interest immediately before termination or as a remainder interest after the power of appointment had disappeared.

The court compared the actual transaction – all property distributed to Bruce – with the state-law distribution that would have occurred under the will. That approach required the court to determine the petitioners' gross terminating distributions, account for liabilities associated with those distributions, and then apply federal gift-tax principles to the rights surrendered.

(2) **Bruce's Testamentary Limited Power of Appointment Did Not Reduce Petitioners' Gifts.** The first issue was whether Bruce's limited testamentary power of appointment substantially reduced the value of Linda's and Peter's remainder interests. Before the trust was terminated, Bruce had executed a will exercising the power in favor of his revocable trust. The petitioners therefore contended that a hypothetical purchaser of their remainder interests would have paid almost nothing because, absent a change to Bruce's estate plan, the petitioners would not receive the trust property upon Bruce's death.

The Commissioner argued that the power of appointment should be disregarded because it was extinguished when the trust terminated. In the Commissioner's view, the petitioners could not have made gifts until the trust terminated because of a spendthrift clause and, at that point, the power of appointment no longer existed.

- The court rejected both arguments but disregarded the power of appointment for another reason. The relevant inquiry was what Linda and Peter would have received if the beneficiaries had terminated the trust without specifying that all assets were to be distributed to Bruce. Section 12.8 of Clotilde's will provided that, upon the termination of any trust created under the will, the trustee was to distribute the trust assets among its beneficiaries. The distributions did not have to be pro rata, "so long as the distributees receive assets of a value equal to the value of their respective interest in the trust at the time of distribution."

> The Trustee shall not be required to distribute assets of the trust estate, or interests therein, pro rata to the beneficiaries receiving such distributions, but may, in the exercise of the Trustee's discretion, make non-pro rata distributions, so long as the distributees receive assets of a value equal to the value of their respective interest in the trust as of the time of distribution. §12.8 of Clotilde's will:

The court reasoned that Section 12.8 would have required the trustee to value the beneficiaries' interests and distribute assets of equivalent value.

The court acknowledged that a conventional discounted-cash-flow analysis might ordinarily consider Bruce's power of appointment because the "limited power of appointment could well have affected the future distributions to petitioners. Therefore, the limited power of appointment cannot be summarily disregarded simply because it was extinguished by the trust's termination." The difficulty was that the revocable trust named in Bruce's exercise was not itself a beneficiary of the QTIP trust. A cash-flow analysis incorporating that exercise therefore produced aggregate values for the actual trust beneficiaries that were substantially below the stipulated value of the trust assets and required some method of allocating the otherwise unassigned value.

> If the trustee applying section 12.8 of Clotilde's will were to begin by determining the discounted present value of expected future distributions to the beneficiaries, the trustee would have quickly faced a problem. Because of Bruce's limited power of appointment, the aggregate value of the trust interests could not have equaled the value of the trust assets…. The present value of the expected distribution to the Revocable Trust would not be included in the value of either the income interest or the remainder interests in the Residuary Trust.
>
> How would the trustee of the Residuary Trust have made the numbers add up? How, in particular, would the trustee have allocated among the trust's actual beneficiaries (petitioners and their father) the value of the expected future distribution to Bruce's Revocable Trust? (Slip Op. at 16).

Petitioners argued that if the values of the income and remainder trust interests do not add up to the stipulated value of the trust assets, the difference should be allocated proportionately based on the relative values of the income and remainder interests.[1] However, the court observed that the petitioners "cited no authority for why their approach 'must' be followed," and did not adopt that approach.

The petitioners' discounted cash-flow analysis, considering the power of appointment, valued each of the children's remainder interests at only $156,000.

> Petitioners would have us accept that, if they and their father had agreed to terminate the Residuary Trust without specifying a distribution of assets, section 12.8 of Clotilde's will would have required the trustee to distribute to Bruce all but $312,000 of the trust's $117,604,143 of assets. The amount distributed to Bruce would have far exceeded the fair market value of his interest in the trust, measured by the present value of the expected distributions he would have received if the trust had not terminated. More importantly, that result would have been manifestly contrary to the intent reflected in Clotilde's will…. Her will thus reflects a preference that Bruce not have outright ownership of her share of her father's business. (Slip Op. at 16-17).

The court concluded that the trustee applying §12.8 would have assumed that, absent termination, the remaining trust property would pass in equal shares to Linda and Peter at Bruce's death. The holding did not invalidate Bruce's exercise of the power; it prevented that exercise from controlling a hypothetical termination allocation in a manner the court regarded as contrary to the dispositive plan reflected in Clotilde's will.

Holding: If the trust had been terminated without a specified allocation, the trustee would not have reduced Linda's and Peter's distributions because of Bruce's limited testamentary power of appointment.

(3) **Section 2207A Reduced the Value of the Gifts.** The second issue concerned §2207A, which permits a surviving spouse to recover certain transfer taxes attributable to QTIP property from the persons receiving that property. The court held that the value of each petitioner's gift had to be reduced by the reimbursement obligation that would have accompanied the petitioner's hypothetical terminating distribution.

If Linda and Peter had received property corresponding to their remainder interests, the termination would have constituted a disposition of Bruce's qualifying income interest. Section 2519 would have treated Bruce as transferring all QTIP interests other than his income interest. Because Bruce would not have retained all the QTIP property, the rationale for finding no gift by Bruce in the actual transaction would not have applied. Bruce would have made a taxable gift and would have been entitled under §2207A to recover the resulting tax from Linda and Peter.

The Commissioner characterized the reimbursement obligation as speculative because Bruce incurred and paid no gift tax in the transaction actually implemented. The court found that

[1] Under that approach, each child would have made a gift of about $1.7 million rather than $35 million. The IRS determined that Bruce's income interest was worth $10,786,651. (Slip op., n.7). The petitioners asserted that the collective value of their remainder interests was $156,000 x 2, or $312,000. The income and remainder interest values would have totaled $10,786,651 + $312,000, or $11,096,651. That would have left trust assets not allocated to either the income or remainder interests of $117,604,143 - $11,096,651, or $106,507,492. The portion of the unallocated assets that would have been attributed to each child would have been $156,000/$11,096,651 x $106,507,492, or $1,497,314. Therefore, each child would have received $1,497,314 + $156,000, or $1,653,313 under the hypothetical commutation of the trust.

objection misdirected. The gift was measured by a hypothetical alternative transaction. Under that alternative, Bruce would have owed tax, and it was appropriate to assume that he would pay a legally due tax giving rise to his reimbursement right.

> We thus consider what would have happened if petitioners had received the distributions to which they would have been entitled under section 12.8 of Clotilde's will. If petitioners had received *those* distributions, Bruce *would* have owed gift tax and he would have been entitled to recover the tax from petitioners. Under the circumstances, it is appropriate to assume that Bruce would have paid the gift tax owed, giving rise to the right of reimbursement that would have reduced the value that petitioners gave up in allowing their father to receive all the trust assets. (Slip op. at 20).

Accordingly, the economic benefit each petitioner surrendered was not the gross terminating distribution but the amount remaining after the reimbursement obligation. At a 40% gift-tax rate, the net-gift computation divided the gross value by 1.4. Using the Commissioner's original gross valuation of $53,408,746 as an illustration, each petitioner would have retained $38,149,104 after the reimbursement burden.

Holding: Each gift was reduced by the §2207A reimbursement obligation that the petitioner would have incurred if he or she had received a terminating distribution.

(4) **Section 7520 Did Not Determine the Beneficiaries' State-Law Entitlements.** The Commissioner maintained that the termination transformed the petitioners' interests into conventional remainder interests that had to be valued under §7520. The petitioners argued instead that the tables were unavailable because their interests were "restricted beneficial interests" subject to Bruce's power of appointment and other contingencies. (Treas. Reg. §25.7520-3(b)(1)(i) states that "[a] restricted beneficial interest is an annuity, income, remainder, or reversionary interest that is subject to any contingency, power, or other restriction," and standard factors under §7520 "may not be used to value a restricted beneficial interest.")

The court agreed that §7520 did not control, but on a different ground. State law creates and defines property rights; federal law determines the tax consequences of those rights. A trustee allocating assets under §12.8 would first be determining what property each beneficiary was entitled to receive under the will and Washington law. The trustee would not be valuing an interest, in the first instance, "for purposes of" the Internal Revenue Code.

The court emphasized §7520's opening limitation: "For purposes of this title." The prescribed tables could provide guidance, but they were not binding on a Washington trustee or court determining the beneficiaries' rights under the governing instrument. Once the state-law entitlement was established, federal tax law would determine the consequences of surrendering it.

Because the court's conclusion rested on the state-law nature of the allocation, it did not need to decide whether the petitioners' interests were restricted beneficial interests under Treasury Regulation §25.7520-3(b).

The court does not provide a detailed analysis of how to value the income and remainder interests apart from the §7520 tables. (Presumably different discount rates for each interest and assumed growth rates were used, different than the discount rate used under §7520.) The court merely used the values calculated by the parties' experts.

Holding: The §7520 actuarial tables did not control the amounts to which Linda and Peter were entitled upon termination because those entitlements were determined under the will and Washington law.

(5) **Bruce's Actual Age Had to Be Used for Life-Expectancy Purposes.** In determining the present value of the remainder interests following Bruce's death, the petitioners' valuation expert used the life expectancy of an 80-year-old even though Bruce was 85. The adjustment was based principally on Bruce's high income and Linda's description of him as being in generally good health.

Mr. Eckstein [the petitioners' valuation expert] referred to research "indicat[ing] that healthy males categorized as high-earning individuals are likely to outlive the average male of average means." According to a study published in the Journal of the American Medical Association (JAMA), "a 40-year-old male in the top income percentile" had a "9-year greater life expectancy" compared to those with average incomes. Any life expectancy gap based on income, however, would "narrow[] . . . with age." At trial, Mr. Eckstein opined that the JAMA study gave him "very strong support to say that [the Social Security tables] underestimated [Bruce's] life expectancy." On the basis of Bruce's income and "above-average health," Mr. Eckstein concluded that "the life expectancy statistics for a typical 80-year-old" would be "a reasonable approximation for Bruce at age 85." (Slip op. at 6).

The court recognized that income may correlate with longevity, but income was only one of many relevant factors. Standard mortality tables rely on the law of large numbers and inevitably understate some individuals' life expectancies while overstating others'. Selectively adjusting a table for one favorable factor, without examining the full range of favorable and unfavorable factors, introduced potential bias and was methodologically questionable.

The expert did not interview Bruce, review his medical records, or consult an actuary. His information came primarily from Linda, and he knew that Bruce had osteoporosis and mobility limitations. In addition, the expert specialized in valuation rather than actuarial science or medicine. The record therefore did not support an individualized five-year age adjustment.

Using Bruce's actual age, the petitioners' expert's alternative calculation, without considering the power of appointment, produced a value of approximately $37.4 million for each gift.

Holding: Bruce was required to be treated as age 85, his actual age on the valuation date, rather than as age 80.

(6) **Each Petitioner Made a Gift of $35,141,321.** The Commissioner had conceded that each gift was worth no more than $35,141,321 if two conditions were satisfied: the gifts were reduced for §2207A reimbursement and the §7520 tables did not control. The court had resolved both issues against the Commissioner.

The petitioners' own expert's calculation using Bruce's actual age indicated that each gift might have been worth at least $37.4 million. The evidence therefore did not support a value below the Commissioner's conceded amount. Other unresolved matters - including the effect of Bruce's qualified right to principal and the appropriateness of discounts for lack of control or marketability - might have affected the valuation, but they could not increase the result above the Commissioner's conceded ceiling amount. [Observation: Consideration of Bruce's right to distributions and lack of control or marketability discounts would have decreased, not increased the remainder interests and the amount of the gifts. In any event, the Commissioner's conceded amount was less than the petitioners' expert's amount.]

Holding: The court held the Commissioner to the concession and fixed each gift at $35,141,321.

i. **Planning Considerations.**

(1) **Beneficiary Gifts Resulting from Trust Modification or Termination Agreements.** *Lewis-McDougall* resulted in huge gifts by beneficiaries ($35 million by each) who agreed to terminate a trust early. In CCA 202352018, the IRS Chief Counsel opined that beneficiaries made gifts when they agreed to a trust modification to add a discretionary power to reimburse the grantor for income taxes attributable to the grantor trust income (discussed below). Perhaps these developments suggest that the IRS may be focusing on the gift tax effects of trust modifications and terminations.

Transfers in compromise and settlement of a trust or estate dispute typically will be treated as transfers for full and adequate consideration that do not result in gifts. The IRS has issued a number of favorable private letter rulings finding no gift tax exposure in a variety of settlement contexts. *E.g.*, PLRs 201342001, 201104001, 200845028, 200825007, 200638020, and 200209008.

Authority exists for treating the failure to enforce one's legal rights as a gift by that individual in appropriate circumstances. *See* Rev. Rul 84-105 (surviving spouse's failure to object to underfunding of a general power of appointment marital deduction trust); Rev. Rul 81-264 (failure to enforce note payable). Also, consenting to trust modifications in appropriate circumstances can result in a gift. *See* Reg. §26.2601-1(b)(4)(i)(E) Ex.7 ("modification increasing A's share of trust income is a transfer by B and C to A for Federal gift tax purposes").

(2) **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 failing to object or take action to prevent improper distributions. *See* CCA 202352018 (trust beneficiaries made a gift to the 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).

(3) **Trust Termination vs. Assignment of Remainder Interests.** A different analysis might have applied in *Lewis-McDougall* if the parties had first amended the trust (if possible) to remove the spendthrift clause and the beneficiaries had then assigned their remainder interests to their father. That would not have involved the termination of the trust and the necessity of having the trustee allocate trust assets among the beneficiaries in a commutation analysis to determine how the assets would pass in the absence of an agreement of the parties. That commutation analysis to determine the property rights of the income and remainder interests and their values under state law is what resulted in the court ignoring the effect of the testamentary limited power of appointment and of not applying §7520 to determine the values of the income and remainder interests. Rather than using a hypothetical willing buyer-willing seller approach to value the gift made by the children by agreeing to the termination of the QTIP trust, in effect the court applied a hypothetical fair commutation analysis to determine how a trustee would divide the trust assets fairly upon an early termination of the trust. To the extent that a party received more than was appropriate, the other parties would be treated as having made gifts.

If the remainder interests had been assigned, the remainder interests would simply have been valued under the hypothetical willing buyer-willing seller standard, and a hypothetical buyer of the remainder interests presumably would take the power of appointment into consideration. In that circumstance, §7520 would presumably apply if the parties had fixed rights, but the values would be determined under the hypothetical willing buyer-willing seller test if the trust interests were "restricted beneficial interests."

(4) **Was the Valuation Framework Proper? What Is the Proper Time for Determining the Gift Amounts?** The court's valuation framework was to examine the facts after the modification agreement had been signed and to examine what the children would have received if they had not agreed that all assets would pass to their father. Another approach would be to examine the value of what the children owned *before* they entered into the agreement to terminate the trust, and that would be the value of the gifts after agreeing that they would give up all their interests in the trust. At that time, all they owned were remainder interests subject to several big contingencies, including what principal distributions would be made to their father during his lifetime and how the father's power of appointment might be exercised. Those contingencies may have lowered the value of their interests dramatically when valued under the hypothetical willing seller-willing buyer test. A hypothetical buyer likely would have assumed that the father would appoint the assets to family members and not allow them to pass to a hypothetical buyer. That was all the children owned, so how could they make a gift of more than that value?

That seems to be a much more straightforward valuation approach than the approach used by the court. Perhaps the court was concerned about the potential of value manipulation, but the result would have been that the children made a small gift to their father, all the assets would be in their father's estate, and estate tax would be paid on that value at the father's death. There would have been no abuse of the transfer tax system. This leads to the "QTIP regime" augment made in the Tax Court summary judgement proceeding.

(5) **QTIP Regime.** In the summary judgment proceeding, the taxpayers argued that while the Children may have interests under state law as trust remaindermen, H is treated as the owner of the assets for tax purposes under the fiction of the QTIP regime. How can one make a gift of an asset to a donee who already owns the asset for tax purposes? The court disagreed. It addressed the scope of the "QTIP fiction," concluding that it applies for deferring transfer tax until assets are transferred to someone outside the marital unit, but does not apply to transactions by transferees outside the marital unit (such as transfers by the children of their interests in the QTIP trust). "Any rights [H] may have been deemed to hold because of the QTIP fiction do not negate the very real interests [the Children] held …." If the Children had transferred their rights to a third party, the transfers would clearly be gifts; that H was the recipient does not change this conclusion. No doubt, the taxpayers will again make the QTIP regime argument on appeal of this case.

(6) **Devastating Overall Tax Effect; No Estate Tax Offset for Gift Taxes Paid by the Children.** The effect of the planning in *Lewis-McDougall* is that the children made gifts to their father of $70 million, and the father will include the entire $117 million of QTIP assets in his estate for estate tax purposes at his death. The father has reportedly entered into gift and sale transactions to freeze the value in his estate, but $70 million of value is taxed to the children as a gift and will ultimately be taxed to them again when they pay estate tax on their father's estate.

The Internal Revenue Code does not provide a general credit allowing the father's estate to offset estate tax by the gift tax paid by the children. The taxes are imposed on separate transferors. Sections 2001, 2012, and 2013 do not supply a cross-taxpayer credit on these facts, and §2207A affected the value of the children's gifts rather than creating an estate tax credit.

(7) **Income Tax Issue**. Apparently, the IRS did not take the position that the early termination of the QTIP trust resulted in an income taxable transaction between the income and remainder beneficiaries. The IRS has sometimes made that argument in transactions involving early terminations of trusts. Amounts "paid" by the remainder beneficiaries to the spouse for the remainder interest of the QTIP trust may be gifts (and not taxable under §102(a)), but amounts paid for the spouse's income interest may be fully taxable because the spouse's basis in the income interest is zero under the uniform basis rules of §1001(e). The remainder beneficiary may recognize gain to the extent that appreciated property is used to satisfy the value of the commuted income interest. It is hard to say the remainder beneficiaries "purchased" the income interest when the remainder beneficiaries did not receive anything, but they may be treated as having first commuted the income and remainder interests (resulting in an income tax event) and then having gifted their remainder interest to H (an income-tax-free gift). *E.g.*, PLRs 202509010, 201932001-201932010.

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.)

(8) **Actuary to Determine Life Expectancy.** If §7520 does not apply in valuing trust interests, consider using an actuarial expert to determine appropriate life expectancies rather than merely relying on the average life expectancies used in the §7520 tables. A large body of studies supports the conclusion that persons with higher income and those who live in higher-income communities have longer life expectancies (which would therefore reduce the value of remainder interests following life interests). *See* Richard Franklin & Claudia Tordini, *Well-Being Supported by Family Wealth—A Foundation to Flourish*, BLOOMBERG ESTATES, GIFTS & TRUSTS J. (May 14, 2020); Richard Franklin & Claudia Tordini, *"Health" in HEMS Means Complete Well-Being*, 50 ACTEC L.J. 339, at 361 n.102 (Summer 2025).

(9) **QTIP Trust Planning Is Difficult**. For a more detailed discussion of planning for QTIP trusts, see Item 28.h of LOOKING AHEAD – – Estate Planning in 2026 & Current Developments (Including Observations from Heckerling 2026) (June 1, 2026) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. A brief summary of planning issues follows.

- All of the growth in the value of QTIP trust assets will be subject to estate tax under §2044 at the spouse's death. Planning to avoid or minimize that tax is difficult.
- The trustee may enter into estate freezing transactions directly with the QTIP trust assets (*e.g.*, invest in fixed income portfolios or sell QTIP assets to other family trusts or entities for notes).
- Consider distributions to the beneficiary-spouse pursuant to the trust distribution standards; the spouse can then enter into estate freezing transactions. However, distributions beyond what is permitted under the trust distribution standards may be ignored for tax purposes.
- Classic commutations, in which the spouse merely receives the value of the income interest, would result in a taxable gift under §2519 of the entire value of the remainder interest (that is the clear purpose of §2519 and the spouse receives nothing with respect to the remainder interest to offset the deemed transfer of the remainder interest).
- Terminating QTIP trusts early and distributing everything to the spouse should be viewed as an aggressive transaction; this is clearly on the IRS "hot list" (the Tax Court held that this approach did not result in a deemed gift of the remainder interest under §2519 by the spouse-beneficiary, but the IRS may ultimately appeal a §2519 case).
- Using decanting rather than judicial termination 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.
- In a planning mode, draft QTIP trusts to give someone a power to appoint assets to the spouse-beneficiary (assuming the client is comfortable giving someone that power); Reg. §25.2519-1(e) says appointing assets to the spouse does not trigger §2519 even if the spouse subsequently disposes of the appointed property; the power is not exercisable in a fiduciary capacity, whereas a decision by the trustee to terminate the trust and distribute substantial assets to the spouse must be appropriate and consistent with the trustee's fiduciary duty.
- Similarly, in a planning mode, give the spouse (or someone) a power to appoint the remainder interest at the spouse's death to minimize the possible gift by any particular beneficiary resulting from the beneficiary's assignment of the remainder interest to the spouse; however, the IRS dismissed the impact of the spouse's power of appointment in CCA 202118008 and the court in *Lewis-McDougall* ultimately determined that the power of appointment was not considered in the valuation of the gift when the trust was terminated early.

- Dividing a single QTIP trust into separate QTIP trusts may minimize the §2519 risk; transfers to the spouse to allow transfer planning by the spouse could be made from just one of the trusts, not risking the application of §2519 to the assets of the other trust. Many PLRs have allowed taxpayers to sever QTIP trusts in anticipation of this type of planning. *E.g.*, Ltr. Ruls. 202504006-202504007; 202146001.
- 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); 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. ESTATES, GIFTS & TR. J. 1 (Mar. 14, 2019.

19. 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 PLRs 202628005 and 202630004 (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 rulings 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 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.

The IRS may have subtly backed away from this position in recently issued rulings. PLRs 202628005 and 202630004 (April 14, 2026) (mirror rulings for transfers by spouses) had similar facts – although the differences in the exempt and non-exempt trusts were not noted in the rulings – but the IRS did not include the "we express no opinion" paragraph in the new rulings. Nevertheless, the risk persists that an agent might take that position for some particular non-exempt trust.

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 would ameliorate the risk as to the exempt trust (but a three-year issue could persist under §2035). 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 all three of the 2025 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.

The 2025 PLRs create considerable uncertainty for practitioners and taxpayers alike.

c. **Recent Rulings Without the Troublesome Paragraph**. ACTEC Fellow Lee Brown, Little Rock, recently received PLRs 202628005 and 202630004 (April 14, 2026) (mirror rulings for spouses), granting the right to make a late GST exemption allocation. Importantly the new 2026 PLRs do 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.

Very interestingly, the statement of facts in the new PLRs makes 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 formula general powers of appointment over non-exempt trusts but only had testamentary limited powers of appointment over exempt trusts. The PLRs merely say that "[e]ach child has a limited testamentary power of appointment to appoint their trust share to their descendants." Therefore, someone reading the new PLRs without knowledge of the background facts 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 these rulings had detailed conferences with IRS officials in the process of obtaining the PLRs, 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 the IRS may have changed its position about possibly taking the position that §§2036-2038 apply 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 or general power of appointment 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. (That would be an outrageous result.)

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 PLRs 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). Alternatively, the exempt and non-exempt trusts could both have identical limited powers of appointment designed so that the power of appointment for the

non-exempt trust could be exercised in a manner that would trigger the "Delaware tax trap," causing estate inclusion for the beneficiary exercising the 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.** Another possible counter-argument is that the donor's ability to request IRS authority to make a late allocation as if timely made 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.

20. 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), Gift Tax Stipulated Decision (April 3, 2025), Estate Tax Stipulated Decision (March 25, 2026)

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).

Following the entry of the Order on March 5, 2025, a stipulated decision was entered April 3, 2025, finding no deficiency or overpayment of gift tax. A stipulated decision in the estate case was entered March 25, 2026, finding no deficiency or overpayment of estate tax.

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 Order 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).

The estate took the position that no discount to the lender's note should be applied for gift tax purposes, but that a 30% discount should be applied for estate tax purposes. Estate tax regulations suggest that the estate can demonstrate that the note should be valued at less than face value. Reg. §20.2031-4. The IRS is uncomfortable (to say the least) with that inconsistency of positions for gift and estate tax purposes, but the inconsistency appears to be appropriate. Section 7872 applies for gift and income tax purposes, but not for estate tax purposes. However, §7872(i)(2) says that "under regulations prescribed by the Secretary, any loan which is made with donative intent and which is a term loan shall be taken into account for purposes of chapter 11 [the estate tax chapter] in a manner consistent with the provisions of subsection (b) [providing for the income and gift tax treatment of below-market loans.]" The IRS could adopt regulations applying the concepts of §7872 for estate tax purposes, and indeed a proposed regulation does so, but that proposed regulation has never been finalized.

Prop. Reg. § 20.7872-1 provides:

> For purposes of chapter 11 of the Internal Revenue Code, relating to estate tax, a gift term loan (within the meaning of §1.7872-4(b)) that is made after June 6, 1984, shall be valued at the lesser of:
>
> (a) The unpaid stated principal, plus accrued interest; or
>
> (b) The sum of the present value of all payments due under the note (including accrual interest), using the applicable Federal rate for loans of a term equal to the remaining term of the loan in effect at the date of death.
>
> No discount is allowed based on evidence that the loan is uncollectible unless the facts concerning collectability of the loan have changed significantly since the time the loan was made. This section applies with respect to any term loan made with donative intent after June 6, 1984, regardless of the interest rate under the loan agreement, and regardless of whether that interest rate exceeds the applicable Federal rate in effect on the day on which the loan was made.

The proposed regulation that the IRS proposed to extend the principles of §7872 for estate tax purposes suggests that the IRS viewed §7872 as supplanting the consideration of collectability in valuing notes. The proposed regulation states: "No discount is allowed based on evidence that the loan is uncollectible unless the facts concerning collectability of the loan have changed significantly since the time the loan was made." Prop. Reg. §20.7872-1.

A stipulated decision was entered on March 25, 2026, finding no estate tax deficiency; apparently, the 30% discount was allowed.

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.

The proposed regulation that the IRS proposed to extend the principles of §7872 for estate tax purposes suggests that the IRS viewed §7872 as supplanting the consideration of collectability in valuing notes. The proposed regulation states: "No discount is allowed based on evidence that the loan is uncollectible unless the facts concerning collectability of the loan have changed significantly since the time the loan was made." Prop. Reg. §20.7872-1.

But arguments can be made to the contrary, that collectability concerns can be considered in valuing notes, as 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.

21. 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 20 above.]
  - 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.

22. 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 considered in how the marital estate would be divided because Husband had never relinquished control and both parties benefited from the trust assets throughout the marriage. 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 marital property 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.)

(10) **Divorce Court's Confusion With Grantor Trusts.** Grantor trusts are confusing to divorce courts. The wife's attorney referred in a pejorative manner to the "intentionally defective grantor trust." Divorce court judges have difficulty understanding that the grantor "owns" the trust for federal income tax purposes but has no actual ownership rights.

e. **Drafting Considerations.**

(1) **Limit Distribution Rights Unless Beneficiary's Spouse Waives Rights**. Consider providing that only an independent trustee can make distributions to a married beneficiary, and a married beneficiary will only be entitled to distributions "for that beneficiary's immediate and direct needs for his or her own personal health and basic support needs for food, clothing, and shelter" after considering the beneficiary's other available income and resources unless the beneficiary's spouse irrevocably and permanently waives all rights of any nature which the spouse might have in a beneficial interest in the trust, marital property rights in the trust, or the right to attach trust assets to satisfy the beneficiary's obligations arising out of the dissolution of the marriage. Bruce Stone (Naples, Florida) explains the provision to clients, and only several have asked him to remove the clause.

(2) **Discretionary Distributions By Third-Party Trustee Without Ascertainable Standards**. A beneficiary can argue lack of any control over the trust and distributions if distributions may only be made in the full and absolute discretion of a third-party trustee. As discussed in Item 11.c above, under the Uniform Trust Code, if the trust has ascertainable standards, whether or not subject to the trustee's discretion, the trustee can be compelled to make distributions to satisfy a judgment for support of the beneficiary's spouse or former spouse. UNIF. TRUST CODE §504(c). The presence of an ascertainable standard may even cause the trust to be treated as marital property in some states. *E.g., Comins v. Comins*, 33 Mass. App. Ct. 28, 30-31 (1992), *distinguished in Pfannenstiehl v. Pfannenstiehl*, 55 N.E.3d 933 (Mass. 2016).

(3) **Independent Trustee**. Divorce courts may give more deference to discretionary distribution decisions made by a disinterested, independent trustee. Any third-party trustee would be safer than the beneficiary as trustee. Indeed, if a beneficiary-trustee resigns as trustee during the divorce proceedings, the beneficiary could be held in contempt. *See In re Kloiber*, 98 A.3d 924 (Del. Ch. 2014).

(4) **Expand Spendthrift Provisions**. Draft the spendthrift clause to refer specifically to a spouse and former spouse.

(5) **Kick-Out Provision**. The trust might include a provision eliminating a beneficiary's interest in the trust while the beneficiary is subject to divorce obligations or bankruptcy proceedings.

(6) **Powers Of Appointment**. Powers of appointment add significant flexibility, such as the ability to appoint the assets to someone other than the beneficiary going through a divorce or to remove the beneficiary's interest in the trust.

f. **Trust Administration Considerations.**

- Do not establish patterns of distribution.
- Formalize the discretionary decision-making process regarding distribution decisions.
- Modify problematic aspects of the trust agreement prior to the divorce (preferably well prior to the divorce).
- Delay distributions if a beneficiary's divorce is anticipated or after entry of a judgment in a divorce proceeding.
- Seek court intervention by the trustee to protect the trust (for example, petitioning for instructions, a declaratory judgment, or a protective order).
- Avoid drastic changes in administration during divorce proceedings.
- Consider migrating the trust to a state with stronger creditor protection.
- When a beneficiary is involved in a contested divorce proceeding, engage counsel and consider what the trust can reasonably do to protect itself and the extent to which the trust could or should participate in the settlement discussions to minimize dissipation of the trust.

g. **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.

23. 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 24 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.")

24. 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 23.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 23.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).

25. Trust Treated as Self Settled Trust and Reached by Creditor, Fraudulent Transfer, Special Power of Appointment (SPAT), Bankruptcy Code, *In re Kittrell* (Bankr. D. Az. July 24, 2026)

a. **Brief Synopsis of *Kittrell.*** In *Linscott v. Kittrell (In re Kittrell)*, 2026 WL 2151539 (Bankr. D. Ariz. July 24, 2026), the bankruptcy court applied Bankruptcy Code § 548(e)(1) to an irrevocable "Children's Trust" created and funded by Murphy and Barbara Kittrell. Although the Kittrells were not expressly named as current beneficiaries, they were the grantors and trustees, and they transferred to the trust their interests in entities associated with a highly valuable medical-marijuana business. The court concluded that the Children's Trust was a self-settled trust for purposes of § 548(e). Among other things, the Kittrells' son held a power under which he could add the Kittrells as beneficiaries, revoke the trust and distribute its assets to persons within a class that included the Kittrells, or transfer the assets to another trust that could be for their benefit. The court also relied heavily on the manner in which the trust was actually administered: the Kittrells continued to exercise substantial control over the trust-owned businesses and repeatedly treated trust assets as their own.

The court further found ample evidence of actual intent to hinder, delay, or defraud creditors. The transfers occurred while substantial judgments were outstanding, left the Kittrells without meaningful nonexempt assets, and were accompanied by admissions that creditor protection was an important purpose of the arrangement. The bankruptcy trustee was therefore able to invoke § 548(e)'s ten-year lookback period. The court awarded the trustee a $6.5 million judgment, together with pre- and post-judgment interest, and determined that the assets of the Children's Trust were property of the bankruptcy estate. A separate July 16, 2026 Bankruptcy Appellate Panel decision arising from the same bankruptcy affirmed the denial of the Kittrells' Chapter 7 discharge under § 727(a)(4)(A) because of knowing and fraudulent omissions concerning the Children's Trust and related entities from their bankruptcy disclosures. *Linscott v. Kittrell (In re Kittrell)*, 2026 WL 2151539 (Bankr. D. Ariz. July 24, 2026).

b. **Terrible Facts in *Kittrell.*** *Kittrell* is an unusually strong "bad facts" case. The court was not confronting a carefully administered third-party trust in which the settlors happened to possess one arguably troublesome retained right. Rather, virtually every surrounding circumstance suggested that the formal separation between the Kittrells and the Children's Trust did not correspond with economic reality. The adverse facts included:

- The Children's Trust was created while the Kittrells were already confronting substantial creditor claims and judgments. The transfer of the business interests essentially left them without nonexempt assets from which those creditors could be paid.
- Murphy Kittrell testified that creditors were interfering with his business, and Barbara Kittrell testified that the trust was intended to protect assets from creditors whom she characterized as "thieves." The bankruptcy court later relied on the Kittrells' own testimony that the trust was created to hinder creditors. - The Kittrells were both the grantors and trustees of the Children's Trust.
- Although the children and grandchildren were the nominal beneficiaries, the trust apparently never made a distribution to any beneficiary. It had no separate bank account, maintained little or no conventional trust administration, and filed no separate tax returns; instead, the Kittrells treated the trust's income and losses as their own.
- After purportedly transferring the business interests to the Children's Trust, the Kittrells continued to hold themselves out as owners. Murphy represented himself as owner of trust-owned entities and pledged trust assets in connection with personal obligations.
- The Kittrells continued to use trust-related accounts and assets for personal purposes, including cash withdrawals and payment of personal expenses.
- The trust instrument permitted the Kittrells to hold trust property in their own names, lend to the trust, borrow from the trust, and exercise a substitution power over trust assets.
- Their son could exercise a power of appointment to add the Kittrells as beneficiaries, eliminate other beneficiaries, revoke the trust and direct its assets to a class that included the Kittrells, and, following a later amendment, transfer assets to another trust that could be created for the Kittrells.
- Shortly before bankruptcy, a $15 million business sale generated funds from which more than $11 million of selected obligations were paid, while the creditors who ultimately objected to discharge remained unpaid.
- In their bankruptcy schedules, the Kittrells identified themselves merely as settlors of the Children's Trust, asserted that their children were its sole beneficiaries and that it had "No value to Debtors," and failed to disclose their status as trustees and the full nature of their interests and control.
- The bankruptcy court found their testimony concerning the trusts "vague, inconsistent, and thus lacking in credibility."
- Accordingly, *Kittrell* should be read with appropriate caution before extracting broad conclusions from any one drafting provision. The court had a remarkable accumulation of evidence that the trust was intended to place assets beyond creditors while leaving the Kittrells with practical access to and control over those assets.

c. **"SPATs" and the Son's Special Power of Appointment.** A "special power of appointment trust," or SPAT, generally attempts to avoid characterization as a self-settled trust by not naming the settlor as a beneficiary. Instead, an independent third person is given a nonfiduciary power to appoint property to the settlor, add the settlor as a beneficiary, or appoint property to a separate trust for the settlor's benefit. The theory is that, unless and until the independent powerholder exercises the power, the settlor has no enforceable beneficial interest in the trust. Commentators have described SPATs or "hybrid DAPTs" as potentially offering greater protection than a conventional DAPT, particularly where the settlor is never actually added as a beneficiary and no trust assets are appointed 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).

Kittrell raises an important caution about that planning technique. The Kittrells' son could add as beneficiaries persons who were descendants of the grantors' parents—a class that included the

Kittrells themselves—and could revoke the trust and distribute its assets to persons within that same class. Because of those provisions, the bankruptcy court treated the Kittrells as "contingent beneficiaries" under Arizona law and therefore satisfying the requirement of §548(e)(1) that the debtor be a beneficiary of the self-settled trust. That analysis, if applied broadly, creates a significant concern for SPAT planning: a court may conclude that the settlor's possibility of being added as a beneficiary is itself a present contingent beneficial interest, even though exercise rests entirely with another person. On the other hand, *Kittrell* need not be read as establishing that every SPAT necessarily fails for asset-protection purposes. The power in *Kittrell* was unusually expansive, and it existed against a background of pervasive settlor control, actual personal use of trust assets, creditor-avoidance admissions, and disregard of trust formalities. The better lesson is that SPAT planning should avoid giving the settlor any practical or implied control over the powerholder and should be administered consistently with the proposition that the settlor has no present right to trust benefits. *Kittrell* nevertheless provides creditors with a substantial argument that the "backdoor" itself may constitute the contingent beneficial interest that causes the trust to be treated as self-settled.

d. **Bankruptcy as a Particularly Powerful Creditor Remedy Against Trusts.** *Kittrell* is also a reminder that bankruptcy can dramatically change the asset-protection analysis. Section 548(e)(1) of the Bankruptcy Code gives a bankruptcy trustee the power to avoid a transfer made within ten years before the bankruptcy petition if the transfer was made to a self-settled trust or "similar device," the debtor is a beneficiary, and the transfer was made with actual intent to hinder, delay, or defraud an existing or subsequently arising creditor. That federal ten-year reachback can be far more formidable than the limitation periods that normally apply under state fraudulent-transfer statutes or state DAPT statutes. Even if the court had not treated the trust as a self-settled trust because of the "contingent beneficial interest" held by the Kittrells, it might have treated it as a "similar device." The importance of having an "old and cold" trust created well before creditor problems arise is especially important in a bankruptcy proceeding.

   The contrast between *Kittrell* and the CES 2007 Trust litigation (discussed in Item 51 above) is instructive. The CES trust had existed for approximately a decade before the creditor claim arose, employed an institutional Delaware trustee with sole discretion over distributions, and was administered within a statutory DAPT framework. In *Kittrell*, by contrast, the transfers occurred while creditors were already pursuing the settlors and were accompanied by strong evidence of an intent to shield assets. Once bankruptcy was filed, the trustee could invoke the federal ten-year rule and seek recovery for the benefit of the creditor body as a whole.

   Bankruptcy also presents additional dangers beyond §548(e): as the separate Kittrell discharge litigation illustrates, inadequate or misleading disclosure of trust interests, powers, entities, or transactions can result in denial of the debtor's entire discharge under §727. Thus, even an asset-protection structure that may present substantial obstacles to an individual creditor outside bankruptcy can become much more vulnerable once a bankruptcy trustee obtains the Code's investigatory and avoidance powers.

e. **Substitution Power.** Another provision mentioned in *Kittrell* was Murphy Kittrell's power to substitute assets. The Children's Trust appointed Murphy, individually and in a nonfiduciary capacity under § 675(4)(C), as "Substitutor," with authority, without the approval or consent of the trustee or any other person, to acquire trust assets by substituting property of equivalent value. The Bankruptcy Appellate Panel specifically observed that the substitution power "clearly provides a direct benefit solely to Murphy Kittrell" and treated it as further evidence contradicting the contention that the Kittrells had no beneficial interest in the Children's Trust.

   A substitution power is, of course, a familiar grantor-trust planning provision, and *Kittrell* should not be read as suggesting that the mere existence of a properly structured §675(4)(C) substitution power invariably destroys creditor protection. But context matters. Here, the power required no trustee consent and appeared in a trust in which the settlors already exercised extraordinary practical dominion over the assets. In that setting, the substitution power became one more piece of evidence that the supposed separation between the Kittrells and the trust property was largely formal rather than substantive.

f. **Cumulative Effects of Bad Facts.** For asset-protection planning, *Kittrell* counsels particular care before combining a SPAT-type "backdoor," a broad nonfiduciary substitution power, settlor trusteeship, borrowing rights, and continued operational control over trust-owned assets. The cumulative effect of retained powers and actual conduct may be much more damaging than any one provision considered in isolation.

26. Basis Adjustment at Grantor's Death for Grantor Trust Assets, Joint Grantor Trusts, *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**.

27. 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*, 2026 WL 1642415 (5th Cir. June 8, 2026), *aff'g*, 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).

28. Section 2036 Applied to "Eve of Death" Funding of Limited Partnership by Decedent's Agent, *Estate of Fields v. Commissioner*, 2026 WL 1642415 (5th Cir. June 8, 2026), *aff'g*, T.C. Memo 2024-90

a. **Synopsis.** Decedent's grand-nephew (N), acting under a power of attorney for decedent, transferred about $17 million of assets (all of her assets except $1.5 million of liquid assets and $600,000 of illiquid assets) to a limited partnership (LP) in return for a 99% limited partnership interest. N owned the LLC that was the 1% general partner. The LP and LLC were created and funded when the 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 were not sufficient to satisfy her debts, cash bequests in her will, and estate taxes.

On these facts, it is not surprising that the Tax Court determined that the LP assets were included in the decedent's estate under §2036.

(1) §2036(a)(1): Acting through N as her agent, the decedent had access to the transferred assets (because N owned the LLC that was the general partner, which could control distributions from the LP); use of a significant portion of LP assets to pay various debts and expenses after one's death is evidence of a retained interest.

(2) §2036(a)(2): The partners could unanimously dissolve the LP, so the decedent (through N as her agent), in conjunction with others, could obtain the assets and then designate their disposition, citing *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017).

(3) The bona fide sale for adequate consideration exception to §2036 did not apply. The adequate consideration requirement was met (citing the test from *Kimbell v. United States*, 317 F.3d 257, 266 (5th Cir. 2004)), but the bona fide sale requirement was not met because no nontax reason was a significant purpose for creating the LP. Nontax reasons asserted by the estate were: (a) preventing financial elder abuse; (b) providing for management succession; (c) avoiding difficulties in managing assets under a power of attorney; and (d) streamlining of management.

The Tax Court listed eight reasons those asserted purposes were not viewed as actual purposes for creating the LP, including: (a) lack of planning prior to the decedent's precipitously declining health; (b) lack of contemporaneous documentary evidence of motivations for the transaction other than the attorney's reference to "obtaining deeper discounts"; (c) absence of business interests requiring active management; and (d) depletion of liquidity to the point that post-death obligations could not be paid.

The Tax Court also applied the §2043 analysis from *Estate of Moore v. Commissioner*, T.C. Memo. 2020–40, (but that analysis 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 Tax Court determined that a 3.5% block of thinly traded company stock was entitled to an illiquidity discount, but the 5.7% discount proposed by the IRS's expert, rather than the 10% discount proposed by the taxpayer's expert, was used (because the IRS expert had a more detailed analysis of 32 transactions of private sales of restricted stock that could not be sold for 6-12 months and analogized that to a large block of stock).

The Tax Court applied the 20% penalty under § 6662(a) & (b)(1) for underpayments attributable to negligence or disregard of rules or regulations. The reasonable cause and good faith exception did not apply. A reduction of $6.2 million in value by interposing an LP interest between the decedent and her assets "on the eve of death would strike a reasonable person in [N's] position as very possibly being too good to be true." Therefore, reasonable cause would not exist absent good faith reliance on professional tax advice, but there was no specific evidence that any professional advised that the assets could be reported at the claimed discount.

The case was appealed to the Fifth Circuit Court of Appeals as to two issues: (1) for purposes of §2036(a), whether the transfers to the LP were a bona fide sale, and (2) whether the reasonable cause exception for the 20% accuracy-related penalty under §6662(a), (b)(1) was applicable. The Tax Court's factual findings were reviewed for clear error.

Before the Fifth Circuit, the estate advanced three purported non-tax reasons for the transfers to the Fifth Circuit: (1) to remedy insufficiencies of the power of attorney as to succession and management of assets; (2) to consolidate and streamline management; and (3) to protect against fraud and elder abuse. The Fifth Circuit rejected all three purported reasons, agreeing with factual findings presented by the Tax Court and summarizing six additional reasons the Tax Court gave for concluding that the purported not-tax reasons were not the real reasons for creating the LP.

The reasonable cause exception was not applicable. The Fifth Circuit summarized, "The Tax Court did not clearly err when it determined Milner should have recognized that such a 'fabulous opportunity to avoid tax obligations' was 'too good to be true'" and "merely engaging tax and legal professionals does not, by itself, demonstrate reasonable cause."

Estate of Fields v. Commissioner, 2026 WL 1642415 (5th Cir. June 8, 2026) (Chief Judge Duncan and Judges King and Higginson), *aff'g*, T.C. Memo 2024-90 (September 26, 2024, corrected opinion issued Nov. 4, 2024) (J. Copeland)

b. **Observations.**

(1) **Overview of §2036.** Section 2036(a)(1) requires estate inclusion of assets transferred with a retained right to possession or enjoyment of, or the right to income from the property.

Section 2036(a)(2) requires estate inclusion of property transferred with "the right, either alone or in conjunction with any other person, to designate the persons who shall possess or enjoy the [transferred] property or the income therefrom."

An exception applies under §2036, however, for a "bona fide sale for an adequate and full consideration in money or money's worth."

(2) **Action Under Power of Attorney on the Eve of Death; Decedent's Agent Controlling Distributions as General Partner.** The funding of an LP by an agent under a power of attorney on the eve of death is pretty uniformly the "kiss of death" against §2036 arguments. One of the facts causing estate inclusion under §2036(a)(1) was that N was the decedent's agent under a power of attorney and was also the owner of the LLC that was the general partner of the LP, and the general partner made distribution decisions for the LP. Therefore, decedent, through N as her agent, had access to all the LP assets, and the documents reflect an express retention of access to transferred assets.

(3) **Implied Retained Access to Pay Post-Death Obligations Is Sufficient to Invoke §2036(a)(1); Other Cases (But Not All) Have Also Applied This Reasoning; Planning Considerations**. Cases uniformly have held that a retained interest under §2036(a)(1) does not have to be express but can be implied. Although the decedent likely retained enough liquid assets outside the LP ($1.5 million) to cover her anticipated living expenses (due to her short life expectancy), the court reasoned that the necessity of obtaining distributions from the LP by the estate to cover post-death obligations (including cash bequests and estate taxes) demonstrated an implied agreement of retained enjoyment of the assets transferred to the LP.

Whether needing to access LP assets to satisfy post-death obligations triggers §2036(a)(1) has been addressed in many cases, with varying results. Attorneys have argued in various cases that post-death use of partnership assets should not be used as evidence of retained enjoyment by the decedent (§2036 refers to retained enjoyment by the decedent for life or for any period before death), but various cases have viewed the use of partnership assets to pay post-death obligations as reflecting retained enjoyment under §2036(a)(1). Those cases are *Rosen*, *Korby*, *Thompson*, *Erickson*, *Jorgensen*, *Miller*, *Liljestrand*, *Rector*, and *Beyer* (Tax Court cases) and the *Strangi* Fifth Circuit Court of Appeals case. *Miller* and *Erickson* are two cases in which the court looked primarily to post-death distributions and redemptions to pay estate taxes as triggering §2036(a)(1). In *Erickson*, T.C. Memo. 2007-107, the court emphasized particularly that the partnership provided funds for payment of the estate tax liabilities. (The only liabilities mentioned in the case were gift and estate tax liabilities.) The court viewed that as tantamount to making funds available to the decedent. Although the disbursement was implemented as a purchase of assets from the estate and as a redemption, "the estate received disbursements at a time that no other partners did. These disbursements provide strong support that Mrs. Erickson (or the estate) could use the assets if needed."

Interestingly, Judge Chiechi (the trial court judge in *Beyer*) was not troubled by post-death payments of estate taxes and other liabilities of the decedent's estate in *Estate of Mirowski v. Commissioner*. In *Mirowski*, the LLC distributed $36 million to the decedent's estate to pay transfer taxes, legal fees, and estate obligations. The court observed that the decedent's death was not anticipated at the time of the transfers, and there was no understanding to make LLC distributions to pay the taxes or other amounts due after her death. A distinction in *Mirowski* is that the decedent held a 52% interest in the LLC at her death that would have been sufficient to support the $36 million of distributions, but the distribution was not accomplished by purchasing assets from the decedent's estate or redeeming her interest in the LLC.

What if there are non-liquid assets in the estate and insufficient liquid assets for paying all post-death expenses? John Porter (Houston, Texas) has these recommendations:

(a) It is best is to borrow from a third party, but a bank may be unwilling to make a loan using only the partnership interest as collateral. The bank may want a guarantee by the partnership. If so, partnerships should be paid a guarantee fee. There is a legitimate reason for the LP to give a guarantee, because there will be an IRS lien against the partnership, and the partnership will not want the bank to foreclose on a partnership interest.

(b) Borrow from an insurance trust or a family entity, secured by the partnership interest.

(c) There are three options for utilizing partnership funds: redemption, distribution or loan. *Erickson* involved a purchase of assets and redemption but held against the taxpayer. Pro rata distributions are a possibility, but if they are made on an "as needed basis" that plays into the IRS's hands on the §2036 issue; the estate can argue that distributions for taxes are made all the time from partnerships, but usually for income taxes. John Porter prefers borrowing from the partnership on a bona fide loan, using the partnership interest as collateral. It is best to use a commercial rate rather than the AFR rate (that looks better to the government as an arm's length transaction).

Some attorneys suggest that the preferred approach is to have other family members or family entities purchase some of the decedent's partnership interest to generate cash flow to the estate for paying post-death expenses, so that the necessary cash never comes directly from the partnership.

(4) **Roadmap to Flunking Bona Fide Transfer Requirement.** The reasons given by the court as to why the stated nontax reasons were not significant reasons motivating the creation of the LP provide a roadmap of what to avoid in planning. The court discussed the following eight reasons:

- No discussion of creating the LP until the eve of death;
- No changes in the assets, suggesting that no need for management existed before the LP's creation;
- No financial elder abuse other than what had occurred years earlier;
- No contemporaneous documentary evidence of motivations for creating the LP other than the attorney's reference to "obtaining a deeper discount";
- No pooling of assets for joint enterprise or obvious creation of synergies;
- No business interests requiring active management;
- All transactions by the agent, with the decedent not involved in any planning; and
- A depletion of liquidity to the point that the estate could not pay cash bequests or estate taxes.

(5) **Incorporates Groundbreaking Analysis from Relatively Recent §2036 Cases; *Estate of Powell* and *Estate of Moore*.** The *Estate of Fields* case incorporates the reasoning and approach of several groundbreaking cases in the last several years.

Estate of Fields applies the analysis in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), which applied §2036(a)(2) to a situation in which the partners could act unanimously to dissolve the partnership because the decedent could act "in conjunction with others" to designate who could enjoy the partnership assets. The "alone or in conjunction with" analysis has been the focus of various cases in the last several years following the *Powell* case. For a discussion of *Powell*, *Cahill*, *Morrissette*, and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

Estate of Fields is the first case to repeat and rely on the analysis in *Estate of Moore v. Commissioner*, T.C Memo. 2020-40, of the interaction of §2033, §2036, and §2043. (That analysis of §2043 had been described briefly in *Powell v. Commissioner*.) Under the §2043 analysis, a person may have more estate inclusion by creating an LP than if the person had just retained the assets outright. Under the *Estate of Moore* analysis, the net value included in the gross estate under §2033, §2036, and §2043 is stated algebraically as V = A+B-C, where:

A is the estate's interest in the partnership (at its date of death discounted value) (included in the gross estate under §2033);

B is the date of death value (undiscounted) of the assets contributed to the LP (included in the gross estate under §2036); and

C is the discounted value of the partnership interest received when assets were contributed to the LP (subtracted under §2043.)

In *Moore*, because the decedent died only 27 days after the partnership was funded and because there was no evidence the asset values changed in that time period, "A" and "C" in the formula cancelled each other out, so the value included in the gross estate was the date of death value of the assets contributed to the partnership (undiscounted).

The effect, compared to not creating the LP and continuing to own all the assets outright, is that extra inclusion may result to the extent the date of death discounted value of the LP interest exceeds the date of funding discounted value of the partnership interest. For a detailed discussion of the §2043 analysis in *Estate of Moore*, see Akers & Aucutt, *Estate of Moore v. Commissioner Summary* (April 2020) available **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

29. Early Termination of Charitable Lead Annuity Trust, PLR 202614004

a. **Brief Summary.** Private letter ruling 202614004 (released Apr. 3, 2026) involved the early termination of an irrevocable, 20-year charitable lead annuity trust (CLAT) with ten fixed annuity payments remaining. The annual annuity payments were payable to a donor advised fund (DAF) maintained by a §501(c)(3) sponsoring organization. The trust proposed to obtain a state-court order, pay the DAF the undiscounted aggregate amount of the remaining annuity payments to the DAF immediately, and distribute the remaining corpus to the sole remainder beneficiary, the trustee. The PLR granted the taxpayer's three ruling requests, all regarding private foundation limitations that apply to CLATS, ruling that the payment to the DAF:

(1) was not an act of self-dealing under §4941 (because a §501(c)(3) organization is not a disqualified person);

(2) was not a taxable expenditure under §4945 (because the payment was made pursuant to the CLAT's charitable annuity obligation and for the charitable purposes associated with the sponsoring organization); and

(3) was not subject to a termination tax under §507(c) (because the accelerated payment was treated as satisfying the CLAT's mandatory annuity obligation rather than as a voluntary termination of private foundation status).

The ruling is consistent with earlier rulings involving fixed-term charitable lead annuity trusts (as compared to unitrusts or lifetime annuity trusts where no fixed aggregate unpaid payment amount exists), with the charitable annuity amounts being payable to a §501(c)(3) organization. The ruling is not a general blessing of the early termination of CLATs, but indicates that early termination of CLATs may be possible in limited circumstances if the undiscounted aggregate amount of annuity payments is paid currently to the charitable beneficiary. The ruling only addresses possible private foundation effects and does not address other possible tax issues (such as the possible income tax consequences of the early trust termination). CLAT agreements cannot expressly allow commutation or early termination, so the termination must be authorized under applicable state law (for example, pursuant to a state court order).

b. **Summary of Ruling Analysis.**

(1) **Certain Private Foundation Rules Apply to CLATs, §4947(a)(2**). Section 4947(a)(2) provides that, for a nonexempt split-interest trust with deductible charitable amounts, §§507, 4941, 4943, 4944, and 4945 apply as if the trust were a private foundation, subject to specified exceptions.

(2) **Self-Dealing, §4941**. The relevant threshold question is whether the transaction is between the CLAT, treated as a private foundation for §4941 purposes, and a disqualified person. Treasury Regulation §53.4946-1(a)(8) excludes from the definition of disqualified person, solely for §4941 purposes, an organization described in **§**501(c)(3), other than an organization described in **§**509(a)(4). PLR 202614004 applied that exclusion to the DAF because it was administered and maintained by a qualifying §501(c)(3) sponsoring organization.

(3) **Taxable Expenditures, §4945**. Section 4945(a)(1) imposes an excise tax on a private foundation's taxable expenditures. Under **§**4945(d)(5), an amount is taxable if it is paid or incurred for a purpose other than one specified in §170(c)(2)(B). The accelerated payment in PLR 202614004 was made to satisfy the CLAT's charitable annuity obligation and was treated as serving a charitable purpose. Accordingly, the IRS concluded that the payment was not a taxable expenditure.

(4) **Private Foundation Termination Tax, §507(c)**. Section 507(c) imposes a tax on termination of private-foundation status. Treasury Regulation §53.4947-1(e)(1), however, provides that §507(a) does not apply to a trust described in §4947(a)(1) or (2) by reason of a payment to a beneficiary that is directed by the governing instrument and is not discretionary with the trustee. The IRS applied that exception in PLR 202614004 because the CLAT instrument required the annuity payments and did not give the trustee discretion over whether to make them. Thus, the accelerated payment and subsequent wind-up were not treated as a termination subject to §507(c).

c. **Planning Considerations.** For an excellent overview of planning considerations for the early termination of CLATs, see Richard Fox, *PLR 202614004: Recent Ruling on Early Termination of a Charitable Lead Trust – Why the Path Remains Narrow*, LEIMBERG CHARITABLE PLANNING NEWSLETTER #363 (Apr. 27, 2026).

(1) **Little Guidance Regarding Early CLAT Terminations; Narrow Ruling**. Little authoritative guidance exists regarding the early termination of charitable lead trusts. The little guidance that exists is from other private letter rulings providing that early terminations of fixed-term CLATs do not trigger specified private foundation excise tax consequences (mainly under §4941, §4945, and §507(c)) rather than giving blanket approval of the early terminations for all tax purposes. *E.g.*, PLRs 202432004, 202432005, 202432007, 202432008 (identical rulings) and PLR 201930017. The reasoning of the ruling only applies to fixed-term CLATs (not unitrusts or interests for life), for which the aggregate amount of annuity payments is identifiable.

(2) **Contrast With Early Terminations of Charitable Remainder Trusts**. The facts in PLR 202614004 specified that the full undiscounted aggregate amount of the remaining unpaid annuity payments would be paid to the charitable beneficiary. Some private letter rulings that have approved early terminations of charitable *remainder* trusts have allowed payments to the current non-charitable beneficiary equal to the *present value* of the future non-charitable payments, determined under the §7520 actuarial tables. (Permitting a current terminating distribution of the full undiscounted value of the non-charitable payments in a charitable remainder trust would exceed the present value of the non-charitable beneficial interest in the trust.) *E.g.*, PLRs 200127023, 200208039, 200314021, 200733014, 201325018, and 201325020. Those rulings support paying a current CRUT income beneficiary the actuarial present value of the future interest—often using §7520 and §1.664-4 methods—while avoiding specified self-dealing and termination-tax consequences, but only under carefully controlled facts and without establishing a general safe harbor for all federal tax purposes.

Commutations based on the present value of the charitable beneficial interests have not been recognized for CLATs; *see e.g*. PLR 9734057.

(3) **CLAT Agreement May Not Permit Commutation**. Revenue Ruling 88-27 concluded that a charitable lead annuity interest subject to discretionary commutation or prepayment does not constitute a qualified annuity interest. Instead, early terminations of CLATs must be made pursuant to applicable state law and court approval.

(4) **Income Tax Effects of Early Termination**. The IRS has taken the position in various private rulings that early terminations of trusts can have substantial income tax effects on the trust beneficiaries. *E.g.*, PLRs 202509010, 201932001-201932010. In the context of the early termination of a CLAT, the remainder beneficiary may have to recognize gain if appreciated property is distributed to the charitable beneficiary in payment of the aggregate amount of remaining unpaid annuity payments.

30. Who is a Limited Partner For Purposes of the Exception from the Self-Employment Tax for a "Limited Partner," *K Alain, L.L.L.P. v. Commissioner*, No. 24-60240 (5th Cir. Aug. 12, 2026), *revised opinion of* *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. 2026)

a. **The "Limited Partner" Exception to Self-Employment Tax**. The self-employment tax, sometimes referred to as the SECA tax, is essentially the counterpart for self-employed persons of the Social Security and Medicare taxes imposed on employee compensation. The basic rate is 15.3%—12.4% for Social Security and 2.9% for Medicare. For 2026, the Social Security portion applies only up to the $184,500 Social Security wage base, while the 2.9% Medicare component has no wage ceiling. An additional 0.9% Medicare tax can apply above statutory income thresholds. Generally, 92.35% of net earnings from self-employment is used in computing the tax. Accordingly, limited-partner status can have substantial consequences. For example, if a partner receives a $1 million distributive share from an operating partnership, treating the partner as a qualifying limited partner may remove that distributive share from the SECA base. Even if the partner has already exceeded the Social Security wage base from other earnings, the uncapped Medicare component—and potentially the additional Medicare tax—can make the classification economically significant.

The Internal Revenue Code generally includes a partner's distributive share of partnership trade or business income in the partner's net earnings from self-employment. Section 1402(a)(13), however, provides an important exception for a limited partner. It excludes from net earnings from self-employment "the distributive share of any item of income or loss of a limited partner, as such," other than "guaranteed payments . . . for services actually rendered." 26 U.S.C. § 1402(a)(13). The statute does not define "limited partner." That omission has produced an increasingly important dispute over whether the exception turns on a partner's formal status under state law, the partner's activities in the business, or some combination of the two.

b. **Fifth Circuit Case, *K. Alain, L.L.L.P. v. Commissioner*.**

(1) **Facts and Procedural Background.** *K Alain, L.L.L.P. v. Commissioner*, No. 24-60240 (5th Cir. Aug. 12, 2026), involves Sirius Solutions, L.L.L.P., now known as K Alain, L.L.L.P., a Delaware limited liability limited partnership operating a business consulting firm. In 2014 Sirius had nine individual limited partners and an LLC general partner that owned less than 1% of the partnership; after several partners departed, five individual limited partners remained in 2015 and 2016. Sirius allocated all of its ordinary business income—approximately $5.8 million in 2014 and $7.2 million in 2015—to the individual limited partners and, relying on § 1402(a)(13), reported no net earnings from self-employment with respect to those allocations. The IRS determined that the individual partners did not qualify as "limited partners" for § 1402(a)(13) purposes and increased Sirius's net earnings from self-employment to approximately $5.9 million for 2014 and $7.4 million for 2015. The Tax Court sustained the IRS based on its 2023 decision in *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023).

(2) **Original *Sirius Solutions* Opinion.** In its original January 16, 2026 opinion, *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. 2026), the Fifth Circuit rejected the Tax Court's "passive investor" test and adopted what was essentially a bright-line rule: a "limited partner" under § 1402(a)(13) was a partner in a state-law limited partnership who had limited liability. State law determined whether the relevant legal interests—a limited partnership and limited liability—existed, while federal law determined the tax consequences. Under that approach, the extent to which a limited partner actively worked in or helped operate the partnership generally did not determine whether the exception applied.

(3) **Revised August 12, 2026 Opinion.** On August 12, 2026, the panel denied rehearing en banc but treated the government's filing as a request for panel rehearing, granted that request, withdrew the original opinion, and substituted the revised per curiam opinion under the *K Alain* caption. The revised opinion again vacated and remanded, but it materially changed the governing analysis. On rehearing, the same two-judge majority abandoned that bright-line limited-liability test. The revised opinion holds that the original public meaning of "limited partner" when Congress enacted § 1402(a)(13) in 1977 was **"a partner who plays no significant role in managing or running a business."**

The majority began with two propositions. First, the meaning of a term in a federal tax statute is ultimately a question of federal law; state-law labels do not control. Second, because Congress did not define "limited partner," the term should be given its ordinary public meaning in 1977. Contemporary legal dictionaries described limited partnerships as having general partners who managed the business and limited partners who supplied capital and shared profits but did not take part in running the business. The court also relied on the 1916 Uniform Limited Partnership Act, its 1976 revision, and contemporaneous treatises reflecting the traditional distinction between those who managed or controlled the business and limited partners who did not. At the same time, the majority read those authorities—particularly the First Circuit's earlier decision in *Plasteel Products Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959), which is an older First Circuit state-law limited-partnership liability case—not a § 1402 or SECA case—that the *K Alain* majority used as evidence of the historical understanding of a limited partner's permissible role in partnership management.

Thus, the revised opinion occupies a middle ground. It rejects the original *Sirius* proposition that limited liability is enough, but it also rejects *Soroban*'s requirement that the partner be a "passive investor." In the Fifth Circuit's view, a person can participate to some degree in the partnership—including, apparently, in nonmanagerial aspects of its business—and remain a limited partner. The disqualifying line is crossed when the partner plays a **significant role in managing or running** the business. The court criticized *Soroban* for adopting a passive-investor rule without grounding that rule in the original public meaning of the statutory term.

Judge Graves again dissented, adhering to the view that § 1402(a)(13) protects only partners functioning as passive investors.

(4) **Practical Difficulties in Applying the New Standard**. The new standard is considerably less mechanical than the January opinion and leaves important questions unanswered. The Fifth Circuit supplied no hours test, percentage test, safe harbor, or detailed list of permissible and impermissible functions. It is unclear, for example, whether a senior professional who generates substantial revenue but has little institutional decision-making authority is "running" the business; whether voting on major strategic matters is enough; or how to treat a CFO, head of tax, investment-committee member, or other senior officer who has important responsibilities but does not control the enterprise. Commentators immediately noted that the test creates considerable uncertainty because reasonable people can disagree about when participation becomes a "significant" role in management. The question therefore becomes intensely factual, and partnership agreements, voting arrangements, committee memberships, job descriptions, actual conduct, and perhaps the degree to which the enterprise depends on a particular partner may all assume greater importance.

(5) **Unusual Revised Opinion.** The procedural history is itself noteworthy. The government sought rehearing en banc of the January decision. The Fifth Circuit denied rehearing en banc, but the panel treated the request as a petition for panel rehearing, granted that rehearing, withdrew its previously published opinion, and substituted an extensively revised opinion. The bottom-line judgment remained the same—vacatur and remand, with the taxpayer prevailing against the Tax Court's *Soroban* standard—but the governing rule changed materially from an essentially formal limited-liability test to a federal, facts-and-circumstances inquiry focusing on management and control. Tax practitioners commenting on the decision emphasized how unusual it was for a

published appellate opinion to be withdrawn and replaced in a manner that preserved the result while substantially changing the legal test.

c. **Tax Court's Sorboran "Passive Investor Standard.**" In *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023), the Tax Court rejected the proposition that being denominated a limited partner under state law automatically satisfies § 1402(a)(13). The court placed particular emphasis on Congress's use of the words "limited partner, **as such**." According to the Tax Court, those words require the court to determine whether the individual is actually functioning in the capacity Congress associated with a limited partner rather than merely possessing the state-law title. The court viewed Congress as intending to exclude from SECA earnings that are essentially returns on investment and therefore concluded that "limited partners, as such" refers to **passive investors**. That requires a functional inquiry into the partner's actual roles and responsibilities and the manner in which the partnership generates the income allocated to the partner.

   The distinction from *K Alain* is important. Both courts reject a purely formal state-law-label test and both contemplate an examination of what the partner actually does. But *Soroban* asks, in substance, whether the partner is functioning as a passive investor; the Fifth Circuit permits some participation and asks the narrower question whether the person plays a **significant role in managing or running the business**. A partner therefore could potentially fail the *Soroban* passive-investor test because the partner actively performs services but nevertheless satisfy *K Alain* if those services do not amount to a significant management or operational role. The Fifth Circuit expressly described its management/nonmanagement distinction as "different and more refined" than the Tax Court's passive-investor approach.

d. **Other Courts of Appeals and Pending Appeals**. The Fifth Circuit appears to be the first federal court of appeals to squarely decide the § 1402(a)(13) question in the context of limited partners in a state-law limited partnership. Earlier courts of appeals had discussed the characteristics of limited partners in other settings. For example, the First Circuit's *Plasteel* decision applied state partnership law and treated control of partnership affairs as inconsistent with limited-partner status, while allowing lesser involvement. Judge Graves's dissent in *K Alain* cited decisions from the Third, D.C., Seventh, Tenth, and other circuits that used "passive investor" concepts when discussing limited partners in securities, regulatory, and other contexts. The majority responded that those non-§ 1402 authorities could not determine the meaning of this particular federal tax statute. Thus, there is not yet an established circuit split on the precise substantive § 1402(a)(13) issue, but two pending appeals could create one.

   (1) **First Circuit—*Denham Capital Management LP v. Commissioner*, No. 25-1349.** *Denham* involves a private-equity management firm whose individual limited partners were substantial participants in the business. The Tax Court, applying *Soroban*, held that the partners were active and fundamental contributors rather than passive investors and therefore subjected their distributive shares to SECA. The First Circuit heard oral argument on February 5, 2026. Much of the questioning concerned a threshold TEFRA jurisdiction issue—whether net earnings from self-employment and limited-partner status could properly have been determined in a partnership-level proceeding—so the First Circuit conceivably could decide the appeal without resolving the substantive definition of "limited partner." Following the August 12 *K Alain* decision, the government notified the First Circuit of the revised Fifth Circuit opinion. As of August 23, 2026, *Denham* remains pending.

   (2) **Second Circuit—*Soroban Capital Partners LP v. Commissioner*, Nos. 25-2079 and 25-2250.** The appeals from the 2023 *Soroban* opinion and the Tax Court's subsequent merits decision are pending in the Second Circuit, which heard oral argument in June 2026. On August 18, after *K Alain* was revised, the Justice Department submitted a Rule 28(j) letter arguing that the new Fifth Circuit standard actually supports the government on the particular *Soroban* facts. The government emphasized the Tax Court's findings that Soroban's three principals controlled virtually every aspect of the firm, were critical to its investment-management activities, and played roles sufficiently central that "but for" those principals Soroban would not exist. The

government therefore contends that, even under *K Alain*, those individuals plainly played a "significant role in managing or running" the business.

(3) **Significance.** The First and Second Circuit decisions will be particularly important. If either adopts *Soroban*'s passive-investor test, a direct conflict with the Fifth Circuit's less restrictive management-and-control test could emerge. If the courts instead adopt *K Alain*, the Tax Court's *Soroban* approach would be substantially weakened. In the meantime, *Soroban* remains the Tax Court's precedent in cases appealable outside the Fifth Circuit absent contrary controlling circuit authority, while cases appealable to the Fifth Circuit are governed by *K Alain.*