Estate Planning Tax Update — Highlights of Current Developments

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The highlights discussed in this summary are addressed in considerably more detail in Akers & Nipp, "LOOKING AHEAD – Estate Planning in 2026 Current Developments & Hot Topics (Sep. 2026), available at www.bessemertrust.com/for-professional-partners/advisor-insights.

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Important Information Regarding This Summary

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1. Trending in 2026

a. Basic estate planning and coordination

b. Transfer planning trends in 2026: Transfer taxes are of diminishing concern for the 99.9% of the U.S. population with assets under $15 million; exemption amount will not likely be decreased anytime soon; transfer planning is still important for clients comfortable making gifts (but likely less SLAT planning); estate tax repeal very unlikely; state estate tax planning still important.

c. Traditional transfer planning activities: First assure lifestyle needs; grantor trusts with GST planning; SLATs; defined value clauses; adequate disclosure; "topping off" gifts

d. Decanting; trust modification

e. Trust flexibility; directed trusts

f. Review of wills or revocable trust agreements with formula credit shelter trusts or GST trusts; addressing "unneeded" (or disadvantageous) trusts

g. Increased emphasis on the use of non-grantor trusts and basis adjustment planning

2. Legislative Developments (Other Than OBBBA)

a. **Trump Administration Budget Proposals.** The Fiscal Year 2026 budget proposal (the "Greenbook"), released on May 2, 2025, does not include any detailed list of legislative tax proposals (similar to Trump first term).

a. IRS Funding.

- Clawback of Funding from Inflation Reduction Act. Much of the $79.6 billion of additional long-term IRS funding in the Inflations Reduction Act of 2022 has been used or has been rescinded (including an additional rescission of $11.66 billion in the Feb. 3, 2026 appropriations package, discussed immediately below).
- FY 2026 Appropriations. 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 reduces funding for the IRS to $11.2 billion, 9 percent less than the $12.3 billion IRS budget for fiscal year 2025.
- Workforce Reduction. The workforce has reduced by about 25%, from about 103,000 employees in February 2025 to about 75,000. Further cuts may be made because of the Administration's reduction in appropriated IRS funding for 2026.
- A report from the Treasury Inspector General for Tax Administration states that revenue from IRS examinations dropped from $10.0 billion in FY24 to $6.5 billion in FY 25, representing a 35% decrease. The report observes that the IRS lost about 27 percent of its Examination and Collection staff from FY24 to FY25, and concludes that "[w]hile the workforce reductions influenced metrics in FY 2025, the downstream effects of these reductions are likely to become more apparent over time." Treasury Inspector General for Tax Administration, *Trends in Compliance Activities Through Fiscal Year 2025* (Aug. 26, 2026).

b. **Second Reconciliation Act in 2026**? If there is a second reconciliation act in 2026 (for the 2026-2027 fiscal year), possible topics 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 before surrendering to a divided government for the last two years of President Trump's term.

c. **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).

d. **Ending Capital Gains on Primary Home Sales**. The No Tax on Home Sales Act (H.R. 1340), introduced in February by House Ways and Means Committee member Jimmy Panetta (D-CA), would raise the exclusion to $500,000 ($1,000,000 for joint returns) and index the cap for inflation Senate Finance Committee member John Cornyn, R-Texas introduced an identical bill. S. 3332) The law currently provides an exclusion of just $250,000 ($500,000 for joint returns), which was set in 1997. The measure has been criticized as primarily benefiting higher income taxpayers. President Trump has indicated he may be open to that relief.

   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.

e. **Indexing Gain on Investment Accounts.** President Trump has expressed support for the concept of indexing stocks and other assets to inflation, so inflationary gains will not be taxed.

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

g. **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).

h. **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: The Congressional Budget Office's (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 economywide 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.

Will bond market pressures lead to legislative changes, impacting taxes and spending?

> Is there any reason to think Congress will finally act? Some recent events suggest that a reckoning prompted by the bond market may be coming soon. Higher yields on U.S. treasuries translate into higher interest costs, which exacerbate the deficit problem…. The consensus is that reducing U.S. debt to a sustainable level will require a three-pronged approach: increasing economic growth, raising revenue, and stabilizing or reducing spending…. Like economists and bond market vigilantes, the CBO agrees that putting the U.S. budget on a sustainable path will require significant policy changes, including both reducing spending on entitlement programs and raising revenue.

Mindy Herzfeld, *Will the Bond Market Force Congress's Tax Hand?*, 192 TAX NOTES FEDERAL 1749 (Sep. 7, 2026).

3. Musings About Selected Provisions of "One Big Beautiful Bill Act" (OBBBA) (the Act)

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**. Tax cuts under "reconciliation legislation" typically sunset after eight or ten years because of a restriction in the Byrd Rule that a reconciliation act cannot have the effect of increasing deficits outside the budget window. That was avoided in OBBBA by applying a "current policy" baseline (which had never been done before in reconciliation legislation). (The Senate simply voted, by majority vote, that the approach did not violate the Byrd Rule.) That approach will likely be used in future reconciliation legislation.

c. **Estate and Gift Exclusion Amount.** The "permanent" $15 million (to be inflation adjusted) federal estate and gift exclusion amount provides a level of stability to the transfer tax system we have not had for decades. A reduction of the exclusion amount is unlikely in the foreseeable future. There is no discussion of estate tax repeal. 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 (§651 & §661), and charitable deductions (§642(c)) 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 as 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).

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 …

(7) **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 …

(8) **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.

(9) **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.

(10) **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."

(11) **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.

(12) **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.

(13) **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 – Distribution deduction), or 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).

(14) **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.

(15) **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).

e. **Charitable Planning**. The Act adds a 0.5% floor on charitable deductions and allows an above-the-line charitable deduction of $1,000 ($2,000 for joint filers) (not indexed for inflation) for non-itemizers. The Tax Foundation estimates that nearly 86% of taxpayers will take the standard deduction in 2026. If an individual does not have substantial deductions other than charitable deductions, "bunch" charitable contributions (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.

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).

g. **Trump Account Reporting on Gift Tax Returns.** 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).

- <u>Five Safe Harbor Requirements</u>. 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.

- Observations.

- 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)).
- 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).
- 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.**"
- 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.

h. **Trump Account Investment Options; Guidance Regarding Employer-Sponsored Programs for 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).

i. **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).

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.

j. **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 8 below.

4. 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 have been 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.

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.

   Transfer planning involving closely held entities must navigate potential estate tax inclusion attacks under §2036 and §2038 if the donor has expressed or implied retained interests or controls. See Item 25 of LOOKING AHEAD – Estate Planning in 2026 Current Developments & Hot Topics (March 2026).

   This may be a good time for reporting gift and sales transactions to commence a 3-year period of limitations on the assessment of additional gift tax 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**. The large exclusion amount means that many clients will not have federal transfer tax concerns (but many states have estate taxes with exemptions much lower than the federal exemption). While grantor trusts offer very significant advantages for transfer tax planning purposes, planning with non-grantor trusts may become more significant for various purposes (*e.g.*, income shifting, SALT deduction caps, QSBS stacking, state income tax savings), but the multiple trust rule of §643(f) must be avoided.

   Structuring a trust as a non-grantor trust is not necessarily easy; landmines must be carefully navigated. The general rule is that a trust is a grantor trust if anyone, including the grantor or grantor's spouse, has a power of disposition affecting beneficial enjoyment of the income or corpus without the consent of an adverse party. (§674(a)) For a detailed checklist for structuring non-grantor trusts, see Item 8.c of LOOKING AHEAD – Estate Planning in 2025 Current Developments & Hot Topics (Dec. 31, 2025), found here and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

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

e. **Changed Paradigm.** 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, qualifying gifts as present interests or qualifying bequests for the estate tax charitable deduction will be irrelevant for most of population. 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).

f. **Will Updating; Planning Issues for Unneeded Existing Trusts.** 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.

5. Basis Adjustment Planning

a. **Significance.** 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 exclusion amount is indefinite and does not sunset after a period of time. The exclusion amount likely would be reduced only if a future Congress has Democratic majorities in the House and Senate well in excess of a mere greater-than-50% majority.

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

- 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). 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). Estate inclusion theoretically could occur under §2036(a)(2) even before the power of appointment is actually granted, but would not apply if the power is merely to grant a *testamentary* limited power of appointment.
- Repurchase appreciated asset from grantor trust.
- Avoid valuation discounts for FLP/LLCs. (Possible estate inclusion under §2036 under *Powell* and *Estate of Fields* cases; or amend agreement to remove transfer restrictions as much as possible; or convert to a general partnership.)
- Does donor use of gifted property create an implied agreement of retained enjoyment, triggering estate inclusion under §2036(a)(1)?
- Sell loss assets to grantor trust (to avoid a step-down in basis under §1014).

c. **Basis Adjustment for Beneficiary.**

- 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).
- Structure trust so someone can grant a general power of appointment to the beneficiary, which possibly could be exercisable only with the consent 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 and consider providing that the powerholder has no duty to monitor whether a general power should be granted. Query, is it a power exercisable "in conjunction with another person," making it a general power under §2041(b)(1)(C) even though never granted?

- Use a formula general power of appointment.
- 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.
- 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.
- Plan to obtain a basis adjustment at the first spouse's death regardless of which spouse dies first by using community property (or possibly a community property trust) or a joint trust structured as a "JEST" trust.
- 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.
- Make an "upstream" gift, giving a "non-rich" ascendant a general power of appointment.
- GST impact – 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).

d. **Testamentary Planning.**

- Most of the population is not subject to the estate or gift tax. (However, non-U.S. persons are still subject to estate taxes with an exemption of only $60,000.)
- Review formula clauses to make sure the large exclusion amount does not upset intended results.
- Even low to moderate-wealth individuals cannot ignore the GST tax.
- Clients who are no longer subject to transfer taxes may wish to change existing trusts that are designed to save transfer taxes. 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 taxes on the trust's income.
- Structuring approaches

    - 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.
    - Couples with assets over $15 million but less than $30 million – make use of the first decedent-spouse's exclusion amount with an outright gift with disclaimer planning or a QTIPable trust approach, creating flexibility through the manner in which the portability election is made (the portability election could create the possibility of using both spouses' exclusion amounts but allowing a basis adjustment of all of the estate assets at the second spouse's death).
    - 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 or both spouses have potential access to some of the transferred assets for clients making large transfers.
- Increased importance of portability
- The QTIPable trust approach is very flexible (it could include a *Clayton* provision).
- QTIPable trust with delayed power of withdrawal – If 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 (*e.g.*, sometime after the estate tax filing date). Reg. §20.2056-5(a)(4) ("must be exercisable in all events") & §20.2056-5(g)(1).

6. Miscellaneous Administrative and IRS Guidance; Finalized Regulations; Forms

a. Executive Orders.

- An executive order dated January 31, 2025, reinstates an April 11, 2018 memorandum of agreement between the Treasury and OMB to allow OIRA to review proposed regulations. The order also stipulates that for every new regulation, 10 other regulations should be identified for repeal.
- An executive order dated Feb. 19, 2025, charges agency heads to identify 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.
- 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."

b. **Inflation Adjusted Amounts**. The inflation adjusted amounts for 2026 (based on C-CPI-U data for August 2025) were announced in Rev. Proc. 2025-32 (Oct. 9, 2025). Some of the numbers for 2026:

- The Act provides that the estate, gift and GST "exemption" amount for 2026 is $15 million, to be inflation adjusted in subsequent years
- Gift tax annual exclusion – $19,000 (same as in 2025; the annual exclusion had increased by $1,000 in each of the four prior years [2022-2025], after remaining at $15,000 for four years [2018-2021])
- The top 37% income tax bracket for estates and trusts begins at $16,000 in 2026 (up from $15,650 in 2025)

c. **2025-2026 Priority Guidance Plan**. The 2025-2026 Treasury-IRS Priority Guidance Plan for July 1, 2025 to June 30, 2026 (dated September 30, 2025) 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. Some of the excluded projects "may be considered for inclusion on a future priority guidance plan."

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. All 12 provisions in the 2024-2025 Plan in the "Gifts and Estates and Trusts" section were omitted from the 2025-2026 plan (five of those projects were completed in 2024 or 2025). For an excellent summary of the 2025-2026 Plan, see Beth Kaufman, *2025-2026 Treasury-IRS Priority Guidance Plan*, ACTEC CAPITAL LETTER No. 64 (Oct. 8, 2025).

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. **Trump Accounts**. Notice 2025-68 and subsequent proposed regulations (REG-117002-25 and REG-117270-25) describe general investment options for Trump Accounts. Treasury announcements on July 1 and July 2, 2026, listed several permitted specific low-cost funds. (These are discussed in Item 3.h above.) Rev. Proc. 2026-25 describes a safe harbor under which contributions to Trump accounts would be treated as present interest gifts (as discussed in Item 3.g above).

f. **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.

g. **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) effective July 9, 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, (4) 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, rather than as distributions carrying out the trust's ordinary income and capital gain tiers under §664(b). *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.

h. **Section 2801 Final Regulations**. Final regulations under §2801 were issued on January 10, 2025 (T.D. 10027). Section 2801 very generally imposes a tax on certain transfers of property by gift (covered gifts) and on certain transfers of property by bequest (covered bequests) from certain individuals who expatriate on or after June 17, 2008 (covered expatriates).

i. **Basis Consistency Final Regulations; Form 8971**. Final basis consistency regulations were published in the Federal Register on 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: (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. Changes in the final regulations were incorporated in an August 2025 updated version of Form 8971.

j. **Form 709**. Revised Form 709 for 2024 was released Jan. 3, 2025. As one panelist at Heckerling quipped, "The IRS decided the old form was way too straightforward."

   - The mechanics of making the gift-splitting election are dramatically different (and will create confusion).
   - The manner of making the "reverse QTIP election" for gifts to QTIP trusts has also changed (and the election may easily be missed).
   - Software platforms do not seem to be coordinating well with the new forms.

k. **Form 706**. Revised Form 706 for Decedents Dying After 2024 was posted September 4, 2025.

- Schedules are separate documents (and must be downloaded separately); 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.

l. **Form 8971**. Form 8971 was updated in a version dated August 2025. It reflects changes made in the basis consistency final regulations.

m. **Postmark Rule; Clarification from U.S. Postal Service of When Postmarks Are Applied**. Section 7502 provides generally that documents postmarked before the due date will be considered timely filed or paid even if received by the IRS after the deadline. 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. 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."

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. Planners should make clear to clients, when they mail documents and returns to the IRS, that we have a "postmark rule," not a "mailbox rule."

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

a. **Two Reform Projects.**

- Uniform Law Commission, Uniform Conflict Of Laws In Trusts And Estates Act, adopted July 22, 2026
- American Law Institute, Restatement (Third) Of Conflict Of Laws, Tentative Draft No. 6 of that Restatement, which includes Chapter 7, Topic 4: Trusts, was approved on May 18, 2026, subject to meeting discussion and ordinary editorial prerogative.

- Both projects were coordinated so they are consistent.
- Even for states that do not adopt the Uniform Act, courts typically cite and follow the Restatement, so new Restatement provision is very significant.

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

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

d. **Validity Issues**.

- Formal validity (execution) – if formalities of any materially connected jurisdiction are satisfied (to determine if a jurisdiction is materially connected, factors include where executed, domicile, abode, nationality, fiduciary, and property)
- Capacity/Consent (undue influence, fraud) – donor's domicile is emphasized.
- Substantive validity (creation, duration, asset protection, restraints on alienation) – donor choice of law is respected if the chosen state has a **substantial relation** to the trust (*e.g.*, trustee's domicile or place of business) and the selection does not violate **a strong public policy** of the state with the most significant connection to the trust as to the matter at issue; if no choice is made, the default looks to the state with the **most significant connection** to the particular issue. (This is consistent with current law.)
- The Act does not address how to determine if a state has a "strong public policy," but it means more than just having a different law in the other state. Rather, a "strong public policy" of a state would more appropriately be understood to be "some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal." *Loucks v. Standard Oil Co. of N.Y.*, 120 N.E. 198, 202 (N.Y. 1918) (Cardozo, J.).

e. **Construction and Interpretation.** Matters of construction and interpretation are treated the same. The donor/settlor's choice generally controls, with forum evidence rules (for example, rule about authenticity, best evidence, and hearsay) remaining matters of procedure. For construction/interpretation issues, any state law can be selected, and the trust does not have to have any connection with that state. (After all, the trust agreement could just clarify directly what is meant by terms in the trust.) If no governing law is designated, domicile law governs.

f. **Administration.** Administration issues include pretty much everything related to the exercise of trustee powers and duties. General approach (in order): (1) apply the law named by the settlor for administration if the chosen state has a substantial relation (*e.g.*, a trustee in that state); (2) administrative governing law can change if the principal place of administration changes, unless the instrument clearly "locks" administration law notwithstanding a move; (3) if the settlor is silent, apply the law of the principal place of administration; and (4) where multiple states could exercise jurisdiction (*e.g.*, because trustees are amenable to service in more than one place), courts outside the principal place of administration generally should defer (or can defer) to courts of the principal place of administration. The Uniform Act provides guidance in determining the principal place of administration.

g. **Drafting.** Governing law clauses are often unclear as to whether they apply to validity, construction and interpretation, or administration. (For example, the clause may just say "administered under" a particular state law. Does that also apply to issues of validity and construction/interpretation?) The Uniform Act says that "governed by" will presumptively include all three categories of issues.

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

a. **QSBS Overview.** Shareholders in a C corporation have a very significant opportunity to sell the stock and exclude a substantial part (if not all) of the gain on the sale of the stock – if the stock qualifies as qualified small business stock (QSBS) under §1202. Some of the requirements are that the stock was issued after Aug. 10, 1993, the shareholder must have acquired the stock at original issue from the corporation for money or property (not stock) or as compensation (including gifts or bequests of these shares), and over 80% (by value) of the assets must be used in the active conduct of one or more qualified trades or businesses.

b. **Expansion in OBBBA.** The three changes listed below are effective for stock issued after July 4, 2025.

- Tiered gain exclusion (50% exclusion after 3 years, 75% exclusion after 4 years, and 100% exclusion after 5 years)
- Dollar cap on per-issuer exclusion – 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
- Aggregate gross asset threshold – the corporate-level aggregate gross asset ceiling is increased from $50 million to $75 million, indexed for inflation beginning in 2027; stock issued after the corporation exceeds the threshold would not be QSBS

c. **"Stacking" To Maximize Use of $15 Million Cap Exclusion.** If separate family members own stock, each gets its own $15 million exclusion. 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. Multiple non-grantor trusts may be owners, but avoid the §643(f) multiple trust rule by having different primary beneficiaries of each trust.

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.")

A planning alternative to maximize use of the $15 million dollar cap is to transfer QSBS stock to GRATs, with remainders to separate trusts that would be non-grantor trusts after termination of the GRATs.

Stacking planning is increasing dramatically and has resulted in billions of dollars of gain exclusions over the last decade. Reported gain exclusions from trusts and estates were negligible in 2012-2014, but climbed to $6.65 billion in 2021. *See* Gregg Polsky & Ethan Yale, *Fixing the QSBS Stacking Problem*, 192 TAX NOTES FEDERAL 1769 (Sep. 7, 2025). The Treasury assistant secretary for tax policy, Kenneth Kies, warned at a May 2026 conference, "Let me just warn you: We don't like stacking, OK?" Ashlea Ebeling, Richard Rubin, & Peter Santilli, *Silicon Valley Is Obsessed With "Trust Stacking," and the IRS Doesn't Like It*, WALL ST. J, (June 29, 2026). Mr. Kies 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.

Section 1202(k) directs that Treasury "shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise." Commentators have suggested that Treasury could issue regulations providing an anti-avoidance presumption that would apply, for example, "to two or more trusts that both (1) claim excluded QSBS gain from the same issuer by virtue of the $15 million per-issuer cap and (2) have overlapping beneficiaries." Gregg Polsky & Ethan Yale, *Fixing the QSBS Stacking*

Problem, 192 TAX NOTES FEDERAL 1769 (Sep. 7, 2025). Another regulatory alternative would be an anti-conduit framework, treating a nongrantor trust as a conduit of the trust settlor for purposes of the dollar-cap limitation if a principal purpose of establishing or funding the trust was to claim a per-issuer exclusion that would not otherwise be available, and a presumption of bad purpose should arise if multiple trusts were formed by the same settlor for the benefit of related persons and funded with stock of the same issuer shortly before the sale. *Id*.

d. **New Planning Trend: "Packing" To Maximize Use of Ten Times Basis Limitation and $75 Million Aggregate Gross Assets Threshold**. Special rules–

- FMV, not just basis for 10 times basis limitation. 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). For example, if stock is issued in return for a contribution of appreciated property worth $50 million, the 10 times basis limitation would be $500 million.
- Basis, not FMV, for aggregate gross assets threshold. The aggregate gross assets threshold is the basis of the corporation's assets, with some special rules, one of which is that the basis of assets contributed to the corporation is equal to its FMV at the time of contribution. However, the immediate expensing of domestic research and experimental expenditures and 100% bonus deprecation for qualified property, both allowed under OBBBA, may reduce the basis of the corporation's assets.
- Durability. 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.
- Planning if low-basis and high-basis QSBS. Dispose of low-basis QSBS before disposing of high-basis QSBS. The gain on the low-basis shares may be covered by the $15 million dollar cap, leaving the 10 times basis threshold to cover the gain on the high-basis shares.
- Conversion to C corporation. 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, the 10 times basis limitation would be $400 million of gain that could be excluded.)
- Planning observation for technology/research companies or companies with assets qualifying for 100% depreciation. For many technology development or research companies, the largest expense is the salary of developers/researchers, and those amounts can be deducted immediately (as a result of a change in OBBBA, §174A). For AI companies building data farms, the building expenses could be depreciated immediately (OBBBA allows 100% bonus depreciation for eligible qualified property, §168(k)). 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.

9. IRA and Retirement Plan Distributions for Surviving Spouse, Conduit QTIP Trust

a. **SECURE Act; Conduit Trust.** IRA or retirement plan distributions to an individual (or trust treated as an individual) following the death of the owner generally must be paid over 10 years, with five exceptions, one of which is for a surviving spouse. Benefits paid to a spouse may be paid over the spouse's lifetime (with even more beneficial rules if the spouse makes a spousal rollover). Benefits paid to a trust for a spouse qualify for the lifetime payout only if the trust is a "conduit trust" (meaning the distributions from the plan to the trust must immediately be paid to the trust beneficiary).

b. **Special Benefits of Spousal Rollover**.

- 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" 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).

c. **SECURE 2.0 Extends Rollover Benefits to Conduit Trusts for Surviving Spouse**. Under SECURE 2.0, 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.

10. Musings About Artificial Intelligence Issues for Estate Planners

a. **Planning Tip**. 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.

b. **Verbal Prompts**. A panelist demonstrated giving a verbal prompt (several minutes long) describing in 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.

c. **Popular Platforms**. ChatGPT (60.3%), Co-Pilot (14.3%), and Gemini (13.5%) are the most popular generative AI platforms. Others are Perplexity, Claude Opus (which many clients like), Grok, DeepSeek, Brave Leo AI, Komo, Sonnet, and Andi. Users should be aware that DeepSeek is monitored by the Chinese government.

d. **Enterprise Platforms**. 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. Planners should continue to be diligent.

e. **Transcription; Automatic Notetaker Systems**. Fireflies.ai is a free AI notetaker program that is popular. (It is generally considered safe, with robust security features.) 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.) Some planners will not allow calls to be recorded or transcribed.

f. ***United States of American v. Heppner***. 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 (AI is not a lawyer and Claude's terms of service agreement said it does not provide legal advice), (2) they were not created for the purpose of obtaining legal advice from counsel, (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 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.

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.

11. 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. No. 5 (Sept. 17, 2024); High Valuation Placed on Gifts by Remainder Beneficiaries, *Lewis v. Commissioner* & *McDougall v. Commissioner*, T.C. Memo. 2026-58 (July 20, 2026)

a. ***Estate of Anenberg***. *Estate of Anenberg v. Commissioner*, 162 T.C. 199 (May 20, 2024), held that the surviving wife did not owe tax under §2519 as a result of a QTIP trust being terminated by judicial modification to leave all the trust assets to the wife, who then transferred them to descendants. Even if the QTIP trust termination triggered §2519, no gift by wife occurred because she ended up receiving all the assets.

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).

c. ***McDougall* Reviewed Opinion; Final Order as to Father**. The Tax Court issued a reviewed opinion on September 17, 2024, addressing motions for summary judgment. *McDougall v. Commissioner,* 163 T.C. 112 (Sept. 17, 2024). All the gift issues have been resolved regarding H, and a final order and decision for H's case was entered January 30, 2025. (Taxpayers resided in Washington, so an appeal would have been heard by the Ninth Circuit Court of Federal Appeals, but the IRS did not file a timely notice of appeal.)

d. ***McDougall* Holding.**

- No Gift by H of Remainder Under §2519. Relying on *Anenberg,* the court held that 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 almost all the assets to trusts in return for notes resulted in a taxable gift under §2519.
- Gifts by Children. The court concluded that the two Children (the remainder beneficiaries) made gifts by agreeing that all assets could be distributed to H.

e. ***McDougall*, Remand for Determining Value of Children's Gifts.** Factors that could impact the valuation of the gifts by the children to their father are: (1) H, as trustee, can make fiduciary decisions to allocate receipts and expenses between income and principal; (2) the trustee may make discretionary principal distributions to H, which would reduce the value of the remainder interests; and (3) H held a testamentary power of appointment to appoint assets to any of deceased W's descendants. 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]."

A one-and-a-half-day trial on the valuation issue was held before Judge Halpern on June 16-17, 2025. Post-trial briefs of the parties 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.

f. **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).

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

(1) **Valuation Framework.** 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.** 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 petitioners' discounted cash-flow analysis, considering the power of appointment, valued each of the children's remainder interests at only $156,000. Using that as the value of the remainder interests would mean that upon a hypothetical termination of the trust (without agreement that all assets would pass to Bruce) all but $312,000 of the trust assets would have been distributed to Bruce. That would have been "manifestly contrary to the intent reflected in Clotilde's will."

The court concluded that 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. 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.

(3) **Section 2207A Reduced the Value of the Gifts.** 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. Bruce would have been deemed to make a taxable gift of the remainder interests and would have been entitled under §2207A to recover the resulting gift 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 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. Each child's 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.

The court agreed that §7520 did not control, but on a different ground. Section 7520 begins "For purposes of this title." A trustee allocating assets under §12.8 upon the termination of the trust 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.

(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. 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. The court recognized that income may correlate with longevity, but income was only one of many

relevant factors. 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 court held that 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.

h. **Planning Considerations.**

- **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").

- **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).

- **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."
- **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 buyer-willing seller 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 for 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 judgment proceeding.
- **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.

- **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.

- **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.)mm

- **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).

i. **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.
- 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 consent to an early termination of the QTIP trust; 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.
- Consider the possibility of adding such powers of appointment in a decanting action (if allowed under state law); but the failure of remainder beneficiaries to object might still raise gift concerns.
- 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).

12. 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. **Two Surprising Issues Arising in Examinations of GRATs.** 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 v. Commissioner* as "part of the IRS's GRAT crusade." Other planners have noted that the IRS has made and is making these arguments in various pending IRS examinations.

(1) **Valuation.** 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 IRS did not make that argument in its Response in *Elcan*, as discussed below (although it did not stipulate to the accuracy of the values of the contributions).

- CCA 202152018 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.

(2) **Using Grantor Notes to Satisfy Annuity Payments**. 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 as 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 appraisals 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").

- 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. The IRS's Response to the fact that the grantor rather than the GRAT "issued" the note is that "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)."
- The taxpayer's Petition quotes an article by Carlyn McCaffrey for support of the position that using notes from another party (including the grantor) to satisfy annuity payments does not violate the prohibition in the regulations from the GRAT issuing its own note to satisfy annuity payments. The petition quotes the article as follows.

  > The prohibition against the "issuance" of a note or similar financial arrangement does not prevent the use of notes issued by other persons to satisfy the payment obligation. *For example, a note issued by the grantor's spouse, by another trust, or even by the grantor would not violate this prohibition. The trustees of the GRAT might acquire such a note by selling some or all of the GRAT's assets to the issuer of the note*. (emphasis added in the petition). See e.g., C. McCaffrey, "The Care and Feeding of GRATs – Enhancing GRAT Performance Through Careful Structuring, Investing and Mentoring."

b. **Brief Summary of *Elcan***. The that had been contributed to the GRATs. Notes from the grantor received by the GRATs in the substitution transactions were subsequently distributed to the grantor to satisfy required annuity payments. (The final annuity payment could not be fully satisfied with the remaining assets in the GRAT.) The IRS issued deficiency notices to each spouse for $306,929,994 gift tax and $61,385,999 penalties, for total deficiencies of over $736 million.

The notices of deficiency stated that the initial gifts to the GRATs were taxable gifts in their entirety because the grantor's retained annuity interests were not qualified interests under §2702. Alternatively, if the retained interests are determined to be qualified interests, the transfers of the grantor's notes to the GRATs in substitution transactions in which the grantor re-acquired partnership interests and stock that had been contributed to the GRATs were taxable gifts. The notices did not state why the retained interests were not qualified interests under §2702 or why the notes given to the GRATs in the substitution transactions were taxable gifts. Twenty percent accuracy-related penalties were assessed under §6662 because the underpayment was due to negligence or disregard of the rules and regulations.

The IRS's Answer was filed July 9, 2025; it gives no further insight as to the rationale for the gift conclusions in the deficiency notices. *Elcan v. Commissioner*, Tax Court Docket No. 3405-25 (Petition filed March 14, 2025).

c. **Basic Facts of *Elcan*.**

- 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 (after distribution to the grantor of parts of the notes in payment of the annuity amounts).

- 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.

d. **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.

e. **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 in returns for qualified interests under §2702 (without any explanation of why they were not qualified interests); and (2) alternatively, that the transfers of the grantor's notes to the GRATs in substitution transactions in which the grantor re-acquired interests in Frisco and Hercules that had been contributed to the GRATs were taxable gifts.

Twenty percent accuracy-related penalties were assessed under §6662 because the underpayment was due to negligence or disregard of the rules and regulations.

f. **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.

Some of the specific arguments include the following.

- 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 the annuity interests were qualified interests under §2702, and "no further analysis is required."
- Regulations cannot override an unambiguous statute. [Observation: The opening line of a recent Eighth Circuit Court of Appeals case very concisely emphasizes this important principle: "Statutes trump regulations." *3M Company, and Subsidiaries v. Commissioner*, 154 F.4th 574 (8th Cir. Oct. 1, 2025).]
- 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 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 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)."

g. **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.

(1) **Disputed Factual Issues – A Few Observation**s.

- 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.]
- 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.
- Observation: 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 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."

(2) **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).
- 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)."
- 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 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.*]
- "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."
- 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.

(3) **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."
- "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."
- "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*.]
- Section 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."
- Section 2702 does not define "fixed amounts" and does not constrain the IRS from exercising its §7805 authority to promulgate needful regulations.
- 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."

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

- The IRS cannot rewrite §2702's clear and unambiguous plain text, which provides the "best reading" of that statutory provision.
- The IRS improperly departs from §2702's plain text to add new requirements of its own making.
- The IRS's appeals to deference cannot save its rewriting of §2702.
- 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.

i. **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 13 below.]
    - Taxpayers attempt to distinguish post-formation events as “independent transactions that have their own consequences, but the pattern of withdrawing assets in return for notes and reducing the face amount of the notes to satisfy annuity amounts “is clearly relevant” to whether the taxpayers retained qualified interests.
    - Taxpayers violated multiple provisions of the trust agreements. “Each time Petitioner withdrew the assets of the 2018 Trusts in exchange for her personal notes, she left behind no assets with which the trusts could make the annuity payments and then caused the trusts to satisfy the annuity payments with the functional equivalent of the issuance of a note, i.e., reduction of the face amount of her own notes.”

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

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

j. **Planning Considerations.**

- Planning Alternative. 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.
- What to Do Going Forward? 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 literal words of 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 position being taken by the IRS.
- Political Challenges. The IRS is 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).

- 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."

- *Loper Bright* Attack. The regulation itself might be attacked on *Loper Bright* grounds as not being the "best reading" of the statute. The IRS's Response is that the regulation is in accord with the text, legislative history, and purpose of §2702, and that the regulation is a valid exercise of delegated rulemaking authority under §7805 and constitutes a body of experience and informed judgment that is entitled to due respect.
- SWAP Transactions. 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. The IRS's Response stated that 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."
- Interest Rate on Notes. What interest rate should be used in substitution transactions with GRATs? The notes must represent "equivalent value" for the assets acquired from the GRAT. In *Elcan*, the parties used a commercial rate. Arguably, an interest rate equal to the AFR could be used because for gift tax purposes, a transfer in return for an AFR note is not a gift under §7872. Using too high an interest rate could be abusive (it would shift additional value to the GRAT), and the IRS could argue that it would result in an additional contribution to the GRAT, which is prohibited under the regulations. In the event the values transferred to the GRAT in the substitution transaction are determined to be excessive, the taxpayer could take the position (or the trust agreement might explicitly provide) that the excess value is held by the trustee as a constructive trustee for the benefit of the person who made the excess value transfer. (The taxpayers made that argument in *Elcan* in case the IRS should determine that the notes used an excessive interest rate.)

13. 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. **Facts; Decisions.** 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 the mother reported the interest as income on her income tax return. Soon after the third interest payment was made, the mother 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.

Following the entry of an Order on March 5, 2025 (the Order), 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. The judge in these cases was Judge Mark V. Holmes.

b. **Two Separate Gift Tax Issues; (1) Bona Fide Loan and (2) Note Valuation**. 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?

- (1) 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).
- (2) 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 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 [§7872], this transaction was not a gift at all."

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.

c. **Bona Fide Loan Issue Background**. Many cases have addressed the bona fide loan issue. 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). Others list eleven factors. *E.g.*, *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40. The key seems to be whether there is a reasonable expectation of repayment. 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 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. 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).

d. **Non-Payment Risks**. Arguments that non-payment risks should be relevant in valuing notes in loan transactions include:

- The willing buyer-willing seller test would consider all relevant factors that a hypothetical third party lender (or seller for a sales note) would consider.
- *Frazee* and *Estate of True* did not address non-payment risks. *Frazee* and *Estate of True v. Commissioner*, T.C. Memo. 2001-167, both applied §7872 in valuing notes from sale transactions, but neither of them involved non-payment risks.
- Private letter rulings have been consistent in considering non-payment risks in valuing notes received in sales transactions. *E.g.*, Letter Rulings 9535026 & 9408018.

e. **Discounting of Note for Estate Tax Purposes**. 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.

f. **Conclusion About Note Valuation.** 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. This issue has been pursued by the IRS in various recent estate and gift tax examinations (including transactions involving sales of assets for notes), and the IRS will likely continue to press this issue. For example, one such case is *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).

14. 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 (Aug. 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.

All three 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). Both of those problems could cause catastrophic tax results, meaning that trust assets would be included the grantor's estate and GST exemption would not have been effectively allocated to the trust.

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. **Trust Terms and Conclusions in the Private Letter Rulings**. 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. 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.)

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).

Interestingly, the "express no opinion" paragraph in 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 "express no opinion" paragraph 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.

c. **Recent Rulings Without the Troublesome Paragraph**. ACTEC Fellow Lee Brown, Little Rock, recently received PLR 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. **Potentially Devastating Tax Implications of These Rulings**. 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 (the rulings do not mention the incomplete gift possibility).

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.

This is 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.)

Carol Harrington (Chicago, Illinois), one of the country's top experts on GST matters, summarizes: **"40 years of gotcha is just wrong."**

e. Planning Considerations, Including Possible Alternatives To Mitigate These Risks.

- Avoiding the Issue. 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). 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. 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).
- Problematic Situations. Situations in which the IRS could make these arguments include (1) the donor has not allocated sufficient GST exemption to result in a zero inclusion ratio and retains the ability to make a late allocation or to seek ruling to make a timely election (even though made late), or (2) the donor opted out of an automatic allocation on the gift tax return (under §2632(b)(3) for allocations to lifetime direct skips or under §2632(c(5)(B)(i) for allocations to GST trusts) but retains the ability to seek a ruling allowing allocation of GST exemption.
- Affirmative GST Exemption Allocation. 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.
  - However, under the rationale raised by the IRS's statements in these PLRs, a grantor may be unable to allocate GST exemption to a trust with differences between the exempt and non-exempt trusts. The IRS might conceivably raise a "chicken and egg" problem. The allocation of GST exemption may resolve the inclusion issue, but the allocation may be ineffective (because of the ETIP, according to the IRS possible position). 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.
  - 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).
- 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 to a "GST trust" under the automatic

allocation rules, that same reasoning may not apply because the preamble to Reg. §2642-7 suggests that the grantor may have the ability to seek later relief to decrease or revoke an automatic allocation of GST exemption. (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.

  - 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.

- IRS's Future Position. There were informal indications in 2025 that the IRS intended to pursue these positions in future estate audits, especially where the inclusion ratio is not zero and the donor's allocation decision alters beneficial rights. The possibility of inclusion under §2036 and §2038, the existence of an ETIP, and gift incompleteness all would pose substantial risk for taxpayers with similar trust structures. But, perhaps the IRS has changed its position in view of the recent PLR that did not include the "we express no opinion" paragraph.

- Potential Risk Still Exists. 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. *See* Ellen Harrison, *Generation-Skipping Planning in Light of EGTRRA*, 39TH ANN. HECKERLING INST. ON EST. PL. ¶1002.6 (2005).

- Counterarguments. 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. Carol Harrington: "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."

  - The extent to which additional GST exemption could be allocated under an IRS ruling to allow a late allocation as if made timely should not trigger estate inclusion, because it is something the government has to grant and is not within the control of the transferor.

- Statute of Limitations. 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; but this risk exists primarily for trusts for which the inclusion ratio is not zero.

- Planning Going Forward. 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.

  If a trust is already in place with variable terms based on exemption status, decanting may be possible to eliminate distinctions between exempt and non-exempt portions. If the trust is reformed to mitigate the §2036/§2038 issue and ETIP issue in an action that requires the consent of the donor, estate inclusion and a continuing ETIP will exist for an additional three years because of §2035(a) (the donor will be deemed to have "relinquished a power," as described in §2035(a)(1)).

15. 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 considered in dividing 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 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.

Dana Fitzsimons (Bessemer Trust) offers this pithy summary of the case.

- 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. **Central Legal Issue and Case of First Impression in New York.** 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.

c. **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."

d. **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.

e. **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 with 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.

f. **Planning Considerations from *C.S. v. R.H.* Case.**

- The grantor's retained control and economic benefit for the spouses raise the risk that trust assets will be considered marital assets in a property division upon divorce.

- Drafting and structuring implications to maximize divorce protection: (i) use independent trustees, (ii) do not give the grantor a trustee removal power, (iii) do not give the grantor investment powers.
- Respect formalities.
- 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, and the judge found his behavior "unwarranted and hateful."
- Good planning gone awry.
- Section 2036 estate tax inclusion risk.
- 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.

g. **Drafting Considerations**.

- 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.
- 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. 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).
- 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).
- Expand spendthrift provisions. Draft the spendthrift clause to refer specifically to a spouse and former spouse.

- 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.
- 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.

h. **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.

16. 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*. 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."

The decision 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, Vice Chancellor Order Oct. 1, 2025, Magistrate Report May 2, 2025).

b. **Planning Considerations.**

- Creditor not able to reach assets even though DAPT was created under laws of a second state (Delaware), and the debtor's resident state (Michigan) did not have a DAPT law when the trust was created
- DAPTs can own LLCs managed by the settlor, but 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
- Hybrid DAPTs – 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
- SPATs – settlor is not a beneficiary but trust 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 (but using the SPAT approach may be a disadvantage if the debtor ends up in a bankruptcy proceeding, as pointed out in the *Kittrell* case, discussed in Item 18.d below)
- Full Faith and Credit Clause – *CES 2007 Trust* case does not address this issue of whether a judgment in one state will be entitled to "full faith and credit" in an enforcement action

against a DAPT in another state; *In the Matter of Cleopatra Cameron Gift Trust*, 931 N.W.2d 244 (S.D. 2019), did not allow paying a child support obligation (from an out-of-state court order) from a South Dakota trust, relying on a 1998 U.S. Supreme Court case to reason that "the means of enforcing judgments does not implicate full faith and credit considerations"

- Conflict of laws issues – *CES 2007 Trust* case does not address 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; conflict of laws principles may suggest that the governing law selected in the trust will apply if it does not violate a strong public policy of the state with which the trust has its most significant relationship; *see* UNIFORM TRUST CODE §107; *In re Huber*, 2013 WL 2154218 (Bankr. W.D. Wash. 2013) (Washington creditor reached assets in Alaska trust because transfer was a fraudulent transfer and was voidable under §548 of Bankruptcy Act (the transfer was made with actual intent to defraud creditors); trust also held invalid under conflict of laws analysis because Washington (the debtor's state) had a strong public policy against asset protection for self-settled trusts and court applied the law of Washington rather than Alaska); *Toni I Trust v. Wacker*, 413 P.3d 1199 (Alaska 2018) (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 exclusive jurisdiction provision in the Alaska DAPT statute is unconstitutional); *Battley v. Mortensen*, Adv. D. Alaska, No. A09-90036-DMD (May 26, 2011) (original memorandum) (Jul. 18, 2011 (memorandum denying motion for reconsideration) (federal bankruptcy case; Alaska DAPT assets were treated as part of bankruptcy estate; Bankruptcy Code §548(4) allows 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 trust assets from creditors)
- Excess settlor control; de facto trustee argument – the excess settlor control and de facto trustee argument has been raised by various courts in recent years in various contexts; *e.g.*, *SEC v. Wyly* 2014 WL 4792229 (S.D.N.Y. Sept. 25, 2014) (securities law disgorgement case; 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

17. 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 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) **"Hybrid DAPTs"; "SPATs."** See Item 16.b above (in the discussion of *In the Matter of the CES 2007 Trust*) 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. Using the SPAT approach, however, may be a disadvantage if the debtor ends up in a bankruptcy proceeding, as pointed out in the *Kittrell* case, discussed in Item 18.d below.

18. Trust Treated as Self Settled Trust and Included in Bankruptcy Estate, Fraudulent Transfer, Special Power of Appointment (SPAT), Bankruptcy Code, *In re Kittrell* (Bankr. D. Ariz. 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) and §541 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 also concluded that the trust assets are property of the bankruptcy estate under §541 of the Bankruptcy Code because the Kittrells retained and exercised complete control over and derived all benefits of the Children's Trust. The court awarded the bankruptcy trustee a $6.5 million judgment, together with pre- and post-judgment interest. 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.

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, at least for purposes of the Bankruptcy Code.

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. The importance of having an "old and cold" trust created well before creditor problems arise is especially important in a bankruptcy proceeding.

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.

19. Basis Adjustment at Grantor's Death for Grantor Trust Assets, *Belmont Investments, LLC v. Commissioner,* T.C. Docket No. 14039-25 (petition filed Oct. 3, 2025) (taking a position contrary to Rev. Rul. 2023-2)

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

Wife died on December 14, 2018. Thereafter, each trust was longer a grantor trust as to the portion contributed by her, and one-half the assets in each trust were deemed transferred by her to a non-grantor trust. Each trust remained a grantor trust for Husband as to the one-half portion contributed by him.

The trust agreements authorized the trustee to allocate assets disproportionately between trusts so long as the total value of all property owned by each Grantor Trust was divided equally. The trustee allocated the 91.824% member interest disproportionately between 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 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 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**.

- 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.)
- 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).

That argument would depend on a construction of §1041(b) as not providing an exclusive list of ways for property to be "acquired from a decedent" but as merely listing safe harbors of situations in which the property "shall be considered" to have been acquired from a decedent. One reported case has directly rejected that interpretation of §1041(b). *Collins v. United States*, 318 F. Supp. 382 (C.D. Cal. 1970), *aff'd*, 448 F.2d 787 (9th Cir. 1971).

- 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 is apparently the IRS's response to a statement by Secretary of the Treasury Janet Yellen's in a dialogue with Representative Bill Pascrell (D-New Jersey) at a June 8, 2022, House Ways and Means Committee hearing that the IRS would be implementing guidance on the "infamous stepped-up basis loophole … Very soon. Very soon." The IRS responded by adding the issue to the Priority Guidance Plan (released November 4, 2022) and on March 29, 2023, by releasing Rev. Rul. 2023-2. This item was omitted from the 2023-2024 Priority Guidance Plan.
- 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 (or otherwise included in §1014(b)). This result was anticipated. The Ruling reasons in a very straightforward manner that such assets are not in any of the categories in §1014(b) that "shall be considered to have been acquired from or passed from the decedent" and therefore do not receive a basis adjustment under §1014(a). The Revenue Procedure cites a case supporting its position that only transfers described in §1014(b) qualify for a basis adjustment and that no other transfer can be considered as being "acquired from a decedent" as described in §1014(a). *Collins v. United States*, 318 F. Supp. 382 (C.D. Cal. 1970), *aff'd*, 448 F.2d 787 (9th Cir. 1971).
- 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.

20. 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 the 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.

§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.

§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).

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 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 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: (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. **Detailed Discussion of Tax Court Analysis**. The Fifth Circuit supported the reasoning and analysis of the Tax Court. For a detailed summary of the Tax Court analysis and planning observations for limited partnerships and LLCs, see Item 31 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**.

21. Corporate Transparency Act, BOI Reporting Applies Only to Foreign Reporting Companies; Residential Real Estate Reporting Delayed Indefinitely

a. **FinCEN Will Not Enforce for U.S. Citizens or Domestic Entities**. The FinCEN posted a press release on March 2, 2025, stating that it will not enforce any penalties or fines on U.S. citizens or domestic reporting companies or their beneficial owners. It will 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 on Aug. 11, 2026 (RIN 1506-AB67) and published and effective August 14, 2026.

The final rules (1) exempt domestic reporting companies from any BOI reporting requirements, (2) exempt foreign reporting companies (i.e., entities formed under the law of a foreign country that have registered to do business in any U.S. state or Tribal jurisdiction) from having to report the BOI of any U.S. person who is a beneficial owner or company applicant of the foreign reporting company, (3) exempt U.S. persons from having 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), (4) revise the special rule for foreign pooled investment vehicles to exempt any such entity from having to report BOI for any U.S. person who exercises substantial control over the entity, (5) eliminate 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, and (6) confirm that FinCEN will delete information previously filed about any individuals—company applicants, beneficial owners, or recipients of a FinCEN ID—that FinCEN reasonably believes is a U.S. person (e.g., the information is linked to a U.S. passport or U.S. driver's license).

b. **Constitutionality**. Various cases involving the constitutionality of the CTA are ongoing. Few if any of those cases involve foreign reporting companies. Courts have held most of these cases in abeyance pending the release of final rules by FinCEN. The first of the cases finding the CTA unconstitutional was reversed by the Eleventh Circuit. *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).

c. **Nationwide Injunctio**n. An interesting legal issue that has arisen is whether a district court can impose a nationwide injunction. The Supreme Court, in *Trump v. CASA, Inc.*, restricted the authority of district courts to issue nationwide injunctions.

d. **Residential Real Estate Non-Financed Transfer**s. Final rules, issued on August 28, 2024, generally require 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. 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 further suspended enforcement of the reporting requirement on March 23, 2026, by posting on its website, "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*, No. 6:25-cv-00127 (E.D. Tex. Mar. 19, 2026). The court held that several provisions of the Bank Secrecy Act did not support FinCEN's promulgation of those reporting requirements and applied a vacatur, vacating the rules for everyone across the country, not just the plaintiffs. FinCEN is expected to appeal that ruling; the Supreme Court in *Trump v. CASA, Inc.*, 606 U.S. 831 (June 27, 2025), refused to enforce a universal vacatur of an agency's regulations.

Various exceptions to the reporting requirements apply, including gifts by an individual (or an individual and his or her spouse) to a trust of which the same individual(s) are the settlor or grantor. Sales are not included in that exception; accordingly, sales to grantor trusts and transfers to a trust subject to an outstanding mortgage would not qualify for the exception. Also, there is no gift exception for transfers to entities, so transfers of residential real estate property to an LLC would be reportable. A detailed Frequently Asked Questions webpage is available on the FinCEN website, at https://www.fincen.gov/rre-faqs.

22. 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. **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.

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.

c. **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. Other recent cases finding that reasonable cause did not exist include *Estate* *of Fields v. Commissioner*, 2026 WL 1642415 (5th Cir. June 8, 2026), *aff'g*, T.C. Memo. 2024-90, and *Estate of Helen P. Richmond v. Commissioner,* T.C. Memo. 2014-26.

23. 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.

24. 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. **"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.

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.**

- **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).
- **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.

- **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 treats "limited partner" as a federal-law term and holds that its original public meaning in 1977 was a partner who **"plays no significant role in managing or running a business."** The court relied on contemporaneous legal dictionaries, the Uniform Limited Partnership Act and Revised Uniform Limited Partnership Act, partnership treatises, and related case law. It rejected both an automatic state-law-label rule and the Tax Court's formulation that the partner must be a purely passive investor. Under the revised standard, a partner may engage in some nonmanagerial participation, but may not play a significant role in managing or running the business.
- **Practical Difficulties With the New Standard.** The revised opinion does not specify how much management is "significant," identify a quantitative test, or establish a definitive list of permissible activities. Difficult questions may involve authority over ordinary-course decisions, personnel, contracts, investment or client matters, voting and governance rights, participation in day-to-day operations, and whether the partner's activities materially contribute to the partnership's income. 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. 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.
- **Unusual Revised Opinion.** The procedural development is unusual because the same panel did not merely correct a typographical or limited analytical error; it withdrew its prior published opinion and replaced it with a substantially different interpretation while leaving the disposition—vacatur and remand—unchanged.

c. **Tax Court's *Soroban* "Passive Investor" Standard.** In *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023), the Tax Court held that §1402(a)(13) does not automatically exclude the income of every state-law limited partner. The court emphasized the words "as such," reasoning that they require the partner to function as a limited partner rather than be limited in name only. The court concluded that the exception is directed toward earnings of an investment nature and requires a functional inquiry into the partner's roles and activities.

The Tax Court's approach is commonly characterized as a "passive investor" standard. It asks whether the distributive share represents a return on investment or instead reflects the partner's services, active participation, managerial authority, or role in generating the partnership's business income. The decision resolved the legal question that such an inquiry was required; it did not, on the summary-judgment record, make the ultimate factual determination regarding each Soroban partner's status.

The Fifth Circuit's revised *K Alain* standard is less demanding in formulation. Sn active partner might fail under *Soroban*'s passive-investor analysis but potentially qualify under *K Alain* if the partner's participation was not a significant managerial role.

d. **Other Courts of Appeals and Pending Appeals.** The cited appellate authorities identify no other Circuit Court of Appeals that has issued a merits decision resolving the meaning of "limited partner" under §1402(a)(13). Appeals involving *Soroba*n are pending in the Second Circuit, and *Denham Capital Management LP*, No. 25-1349**,** is pending in the First Circuit. Accordingly, those circuits have not yet supplied a competing appellate rule in the cited authorities.

   As of August 23, 2026, the Fifth Circuit's revised decision is binding within that circuit, while the Tax Court's *Soroban* approach remains important outside the Fifth Circuit unless displaced by controlling appellate authority. The pending First and Second Circuit appeals could either adopt the Tax Court's functional approach, adopt *K Alain*'s managerial-role standard, or develop another interpretation. The resulting uncertainty means that appellate venue may affect the treatment of economically similar limited partners until the conflict is resolved by further appellate decisions, the Supreme Court, or Congress.

25. Other Relatively Recent Cases—Valuation, Formula, Indirect Gift, §2036-2038 Issues, Decanting, Assignment of Income, Personal Liability for Estate Tax, Loans, Portability

Each of the following cases are discussed in Estate Planning Current Development papers available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

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

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

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

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

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

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

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

h. *Estate of Cecil v. Commissioner*, T.C. Memo. 2023-24 (2023) (tax affecting allowed in valuing S stock; marketability discounts of 19% for voting stock; 22% for 15.57% nonvoting stock; 27% for 23.36% nonvoting stock; business was valued at its going concern value with zero weight given to its asset value (roughly $15 million vs. $147 million))

i. *Sorensen v. Commissioner*, T.C. Docket 24797-18, 24798-18, 20284-19, 20285-19 (2022) (*Wandry* clause gift tax case settled)

j. *Estate of Horvitz v. Commissioner*, Dkt. No. 20409-19 (Order dated Feb. 7, 2023, Judge Gustafson) (recognition of decanting for tax purposes)

k. *Estate of Hoensheid v. Commissioner*, T.C. Memo. 2023-34 (Mar. 15, 2023); *Keefer v. U.S.*, 130 AFTR 2d 2022-5405 (N.D. Tx. August 10, 2022) (denying motion for reconsideration of Order), 130 AFTR 2d 2022-5002 (July 6, 2022) (assignment of income cases for sales soon after transfers to charity)

l. *United States v. Paulson*, 131 AFTR 2d 2023-1743 (9th Cir. May 17, 2023), *cert. denied* (U.S. Mar. 4, 2024) (No. 23-436) (personal liability for unpaid estate tax by successor trustees and beneficiaries of decedent's funded revocable trust)

m. *Schlapfer v. Commissioner,* T.C. Memo. 2023-65 (May 22, 2023) (gift tax adequate disclosure; substantial compliance analysis)

n. *M. Joseph DeMatteo v. Commissioner*, Tax Court Docket No. 3634-21 (Stipulated Decision Feb. 22, 2024) (valuation of life insurance policies)

o. *Cinader v. Commissioner*, Tax Court Docket No. 13491-22 to 13496-22 & 5245-22 (Stipulated Decision Jan. 3, 2024) (reverse split dollar life insurance)

p. *Estate of Bolles v. Commissioner*, 133 AFTR 2d 2024-1235 (9th Cir. April 1, 2024) (unpublished opinion), *aff'g per curiam*, T.C. Memo. 2020-71 (treatment of advances to son as legitimate loans vs. gifts)

q. *Huffman v. Commissioner*, T.C. Memo. 2024-12 (Jan. 31, 2024) (option agreement not recognized for gift tax purposes under §2703)

r. *Connelly v. United States*, 602 U.S. 257 (June 6, 2024) (Justice Thomas, unanimous), *aff'g* 131 AFTR 2d 2023-1902 (8th Cir. 2023), *aff'g* 128 AFTR 2d 2021-5955 (E.D. Mo. 2021) (buy sell agreement value does not fix the estate tax value; life insurance proceeds payable to corporation under corporate redemption arrangement included in estate tax value and not offset by redemption obligation)

s. *Estate of Becker v. Commissioner*, T.C. Memo. 2024-89 (Sept. 24, 2024) (step transaction doctrine discussed in connection with life insurance proceeds inclusion because of alleged lack of insurable interest)

t. *Estate of Fields v. Commissioner*, 2026 WL 1642415 (5th Cir. June 8, 2026), *aff'g* T.C. Memo. 2024-90 (limited partnership assets included in gross estate under §2036(a)(1) & §2036(a)(2); §2043 analysis; 20% penalty applied, reasonable clause exception not met)

u. *Pierce v. Commissioner*, T.C. Memo. 2025-29 (April 7, 2025) (tax affecting recognized, detailed analysis of determination of discount rate for discounting cash flows to present value, 5% LOC discount and 25% LOM discount)

v. *Estate of Rowland v. Commissioner*, T.C. Memo. 2025-76 (July 15, 2025) (portability election not validly made; failed to timely file a "complete and properly prepared" estate tax return)

w. *Nosirrah Management, LLC v. AutoZone, Inc.*, (W.D. Tenn. April 14, 2025) (Section 16(b) short-swing profits rule did not apply to GRAT payments)