2022 TRUST ADVISORS FORUM

HOT TOPICS IN ESTATE PLANNING

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1. Clawback and Anti-Abuse Regulations

The doubling of the basic exclusion amount by the Tax Cut and Jobs Act of 2017 (the 2017 Act) set the stage for another clawback debate (the first being after the 2012 act). The concern was what effect the sunset of the applicable provisions of the 2017 Act would have on gifts made during the time that the basic exclusion amount was doubled. Would those gifts, although covered under the increased exclusion amount, be clawed-back in to a decedent's estate if he died after the increased exclusion amount disappears? Luckily, Congress partially addressed clawback, adding a new Code Section 2001(g)(2) which provides as follows:

> The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between:
>
> (A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and
>
> (B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent.

On November, 20, 2018, the Treasury released proposed regulations to address the clawback concern. The regulations were finalized in November 2019.

Section 20.2010-(c)(1) of the regulations provides that if the credit attributable to the basic exclusion amount for determining the gift tax payable on any post-1976 gift is greater than the credit attributable to the basic exclusion amount allowable in determining the estate tax liability, then the basic exclusion amount used in computing the donor's estate tax liability will be the higher basic exclusion amount attributed to determining the gift tax payable. The proposed regulations contain the following example:

> Individual A (never married) made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by the cumulative total of $10 million in basic exclusion amount allowable on the dates of the gifts. A dies after 2025 and the basic exclusion amount on A's date of death is $5 million. A was not eligible for any restored exclusion amount pursuant to Notice 2017-15 [addressing same-sex married couples]. Because the total of the amounts allowable as a credit in computing the gift tax payable on A's post-1976 gifts (based on the $9 million basic exclusion amount used to determine those credits) exceeds the credit based on the $5 million basic exclusion amount applicable on the decedent's date of death, under paragraph (c)(1) of this section, the credit to be applied for purposes of computing the estate tax is based on a basic exclusion amount of $9 million, the amount used to determine the credits allowable in computing the gift tax payable on the post-1976 gifts made by A.

Put another way, consider this:

> Bill has an Old Exclusion Amount of $6,000,000 and a New Exclusion Amount of $6,000,000.00. Combined, he has a Basic Exclusion Amount of $12,000,000.00. The New Exclusion Amount "vanishes" January 1, 2026. Assume no inflation adjustment to the Basic Exclusion Amount. Assume Bill has $12,000,000 of wealth.

Bill gives away $9,000,000 of wealth prior to 2026. He pays no gift tax because his Basic Exclusion Amount of $12,000,000 covers the gift. Bill dies in 2026 owning $3,000,000. What is the estate tax occasioned at Bill's death in 2026?

Estate Tax Calculation	
Taxable Estate:	$3,000,000
Adjusted Taxable Gifts:	$9,000,000
Tax Base:	$12,000,000
Tentative Tax (40%)	$4,800,000
2026 Applicable Credit	$3,600,000[attributable to the Old Exclusion Amt used]
Tax Due:	$1,200,000

What these regulations do not provide is an "off the top" option for the use of the New Exclusion Amount. In other words, there is no direction that making a $5 million gift in 2018-2026 will first use the New Exclusion Amount, leaving the Old Exclusion Amount (after sunset of the 2017 Tax Act) to be applied against the estate tax at the donor's death.

The regulations contain the following example:

> Assume that the facts are the same as in Example 1 of paragraph (c)(2)(i) of this section except that A made cumulative post-1976 taxable gifts of $4 million. Because the total of the amounts allowable as a credit in computing the gift tax payable on A's post-1976 gifts is less than the credit based on the $6.8 million basic exclusion amount allowable on A's date of death, this paragraph (c) does not apply. The credit to be applied for purposes of computing A's estate tax is based on the $6.8 million basic exclusion amount as of A's date of death, subject to the limitation of section 2010(d).

Do gifts during the period that a donor has both the Old Exclusion Amount and the New Exclusion Amount use the New Exclusion Amount first? According to the proposed Regulations, the answer is no. If a donor who has not previously made any taxable gifts makes a $6,000,000 gift in 2022, and if the donor dies after the New Exclusion Amount sunsets, the donor effectively will be treated as having used the $6,00,000 of the Old Exclusion Amount, and the donor will not have made any use of the New Exclusion Amount. To take advantage of this "window of opportunity" in case the New Exclusion Amount later disappears, the donor must make a gift in excess of the $6,000,000 Old Exclusion Amount.

The preamble to the final regulations also adds an anti-abuse warning.

> A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death. Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2),

> such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

To illustrate when such an anti-abuse rule would apply, consider in the above example that instead of making a $9 million gift, Bill instead made a $9 million transfer which was subject to inclusion in his estate under Code Section 2036. In that situation, Bill should not get the benefit of the higher exclusion amount in effect when he made the transfer. Consider the following:

> Bill transfers $9,000,000 of wealth to a trust prior to 2026, but retains the right to direct the use or enjoyment of the property. He pays no gift tax because his Basic Exclusion Amount of $12,000,000 covers the gift. Bill dies in 2026 owning $3,000,000. What is the estate tax occasioned at Bill's death in 2026?

Estate Tax Calculation	
Taxable Estate:	$3,000,000
2036 inclusion :	$9,000,000
Tax Base:	$12,000,000
Tentative Tax (40%)	$4,800,000
2026 Applicable Credit	$2,400,000 [tax on basic exclusion amount at death]
Tax Due:	$2,400,000

Under the anti-abuse rules, Bill would get no benefit from the larger basic exclusion amount in effect at the time he made the transfer.

The first Treasury-IRS Priority Guidance Plan of the Biden Administration, published on September 9, 2021, describes "Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of § 20.2010-1(c)" as one of the items the Administration would like to address. It seems likely we will have regulations on this matter sooner, rather than later.

2. Connelly v. U.S., 128 AFTR 2d 2021-5955 (E.D.Mo., September 2, 2021).

The central question of this case was the proper valuation of a closely held business entity. Michael Connelly and his brother, Thomas, owned Crown C Supply, Inc. ("Crown C"). Michael was president, CEO and majority shareholder, owning just over 77% of the shares. Thomas owned the remaining shares.

The stock agreement for Crown C (the "Agreement") provided that upon one brother's death, the surviving brother had the right to buy the decedent's shares, but the Agreement required Crown C to redeem the deceased brother's shares if the surviving brother chose not to buy them. To fund this redemption obligation, Crown C bought $3.5 million life insurance policies on each of Michael and Thomas.

Article VII of the Agreement provided two mechanisms for determining the price at which Crown C would redeem the shares. The first option was for the brothers to "determine the agreed value per share by executing a new Certificate of Agreed Value" at the end of every tax year. If the brothers failed to execute a Certificate of Agreed Value, then they would determine the "appraised value per share" by securing two or more appraisals. The Connelly brothers never signed a Certificate of Agreed Value.

Michael died on October 1, 2013, and Crown C received the $3.5 million life insurance proceeds. Thomas chose not to buy Michael's shares, so Crown C redeemed the shares with a portion of the insurance proceeds. Crown C and the estate did not obtain appraisals for the value of Michael's shares as required under the Agreement, and instead entered into a purchase agreement for the price of $3 million. Pursuant to the purchase agreement, the estate received $3 million in cash, Michael's son, Michael Jr., secured a three-year option to purchase Crown C from Thomas for just over $4 million, and in the event Thomas sold Crown C within 10 years, Thomas and Michael Jr. agreed to split evenly any gains from a future sale.

Thomas was executor of his brother's estate, and filed an estate tax return valuing Michael's Crown C shares at $3 million as of Michael's date of death. The IRS disagreed and determined that the fair market value of Crown C should have included the $3 million in life insurance proceeds used to redeem the shares, resulting in a higher value for Michael's Crown C shares than was reported on the estate's Form 706.

As with any valuation case, this matter came down to a battle of the experts. The estate's expert argued that the Agreement created an enforceable contractual obligation to use the life insurance proceeds to purchase Michael’s shares upon his death. Therefore, the expert opined that the life insurance proceeds used to redeem Michael's shares should be excluded from the fair market value of Crown C.

The Service’s expert instead determined that "in a fair market equity valuation, the insurance proceeds would be included in the value of Crown C as a non-operating asset." He opined that allowing the redemption obligation to offset the insurance proceeds undervalued Crown C's equity, undervalued the decedent's equity interest, and violated well-established equity valuation principles because the resulting share price created a windfall for a potential buyer that a willing seller would not accept.

In determining which experts’ opinion to give more weight to, the Court turned to the Agreement. The Court noted that to control the value of the decedent's property for estate tax purposes, a buy sell agreement must meet three statutory requirements: (1) it must be a bona fide business arrangement; (2) it must not be a device to transfer property to members of the decedent's family for less than full and adequate consideration; and (3) its terms must be comparable to similar arrangements entered into by persons in arm’s length transactions. The court also noted that case law has further developed this rule and requires that a buy-sell agreements must also meet several additional requirements, namely (1) the offering price must be fixed and determinable under the agreement; (2) the agreement must be legally binding on the parties, both during life and after death; and (3) the agreement must have been entered into for a bona fide business reason and must not be a substitute for a testamentary disposition for less than full inadequate consideration.

The parties disagreed as to whether the Agreement met all of the requirements necessary to make it binding in determining the valuation of Crown C's shares for estate tax purposes. If the Agreement did not meet all of the requirements, then the value of the shares would be their fair market value. Naturally, the estate urged that the Agreement met all of the requirements, while the IRS argued that (1) the price of the decedent's company's stock was not determinable from the stock purchase agreement; (2) the stock purchase agreement's terms were not binding throughout Michael's life or after his death; (3) the Agreement was not a bona fide business arrangement and its terms were not comparable to similar arm’s length arrangements; and (4) the Agreement is an impermissible substitute for testamentary disposition.”

The Court first turned to the question of whether the Agreement was a bona fide business arrangement. It noted that the ultimate question of whether an agreement is a bona fide business arrangement is a question of fact, and that to establish this the estate only needed to show that the Connelly brothers entered the Agreement for a bona fide business purpose. The court noted that the parties had stipulated that the brothers entered into the agreement for the purpose of ensuring continued family ownership over the company, and therefore held that it was a bona fide business arrangement for purposes of summary judgment.

The Court then considered whether the Agreement was a device to transfer wealth to the decedent's family for less than full and adequate consideration. The Court held that the estate failed to show the Agreement was not a device to transfer wealth to Michael's family members. The Court first noted that the $3 million redemption price under the Purchase Agreement was not full and adequate consideration. It was only equivalent to the fair market value of the shares if $3 million life insurance proceeds were not included in Crown C's value. Further, the Court noted that Thomas and the estate disregarded the appraisal requirement in Article VII of the Agreement, and failed to obtain professional advice on setting a redemption price.

The Court also noted that the Agreement lacked a minority discount for Thomas' shares in the corresponding lack of control premium from Michael shares. The Agreement explicitly required that in determining the appraised value of the shares, the appraisal shall not take into consideration premiums or minority discounts. The Court held that the Agreement's lack of a control premium for Michael's majority interest indicates that the price was not full and adequate consideration and demonstrated that the Agreement was a testamentary device to transfer wealth to Michael's family members for less than full and adequate consideration.

The Court next tuned to whether the Agreement was comparable to similar arrangements negotiated at arm's length. The estate argued that the Agreement was comparable to similar arrangements because closely held family corporations often use life insurance proceeds to redeem its shareholder stock. The Court held that just because closely held family corporations generally use life insurance proceeds to fund a redemption obligation does not establish that this particular Agreement was comparable to an arm's length bargain, particularly when the $3 million valuation was so far below market value.

Having addressed the regulatory requirements, the Court then turned to the additional requirements imposed by case law. First, the Court held that the price of Michael's shares was not fixed and determinable under the Agreement because Thomas and Michael never followed the valuation process set forth in the Agreement.

Based on all of this, the Court held that the Agreement was not binding upon the question of valuation of Michael's shares for estate tax purposes. Therefore, the value would be the fair market value on Michael's date of death, or "the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts."

The estate argued that the fair market value of the Crown C should not include the $3 million life insurance proceeds because the proceeds were offset, dollar for dollar, by the obligation to redeem the Michael's shares under the Agreement. Accordingly, the estate argued that a hypothetical "willing buyer" of Crown C would have to account for substantial liabilities like Crown C's redemption obligation, and would therefore pay less for a company encumbered with the purchase obligation. The estate based its argument on an 11th Circuit case, *Estate of Blount*, 428 F.3d at 1338 (11th Cir. 2005).

In that case, a closely-held family company entered into a stock purchase agreement with the shareholders, intending that the company would use life insurance proceeds to redeem a key shareholder's shares upon his death. When the shareholder died, his estate argued that the life insurance policy should not be included in the value of the company for purposes of determining fair market value of the redeemed shares because of the company's offsetting contractual obligation to redeem those shares from the estate. The Tax Court in *Blount* determined that it was right to include the life insurance proceeds in the value of the company and that the redemption obligation was not like an ordinary liability of a company because the redemption involved the very same shares being valued. The 11th Circuit reversed the tax court and held that the stock purchase agreement did create an offsetting contractual liability. The 11th Circuit held that the insurance proceeds were "not the kind of ordinary nonoperating asset that should be included in the value of [the company] under the treasury regulations" because they were "offset dollar-for-dollar by [the company's] obligation to satisfy its contract with the decedent's estate.

The Court in *Connolly* respectfully disagreed with the 11th Circuit, and agreed with the Tax Court when it observed that a redemption obligation is not a value depressing corporate liability when the very shares that are subject to the redemption obligation are being valued. The Court reasoned that a willing buyer purchasing Crown C shares on the date of Michael's death would not demand a reduced purchase price because of the redemption obligation. The willing buyer would buy all of Crown C's outstanding shares for $6.86 million acquiring the $3.86 million in shares, plus the $3 million life insurance proceeds. If Crown C had no redemption obligation, the willing buyer would own 100% of the company worth $6.86 million. But the Court noted even with the redemption obligation, Crown C's fair market value remained the same. Once the buyer obtained Crown C outright, the buyer could either (1) cancel the redemption obligation to himself and own 100% of the company worth $6.86 million or (2) let Crown C redeem the shares, in which case the buyer would still own 100% of the company valued at $6.8 million in assets. For these reasons, the Court in *Connelly* found that the 11th Circuit's opinion in the estate of *Blount* was "demonstrably erroneous", and that there were "cogent reasons for rejecting it.".

3. Estate of Moore v. Comm'r, 128 AFTR 2d 2021-6604 (9th Cir. 2021)

This is an appeal of the *Moore* Tax Court case decided in 2020. That case involved valuation of assets held in a family limited partnership at a decedent's death, and also an estate's claimed charitable contribution deduction. The Tax Court held that the entire value of the assets held by the family limited partnership should be included in the decedent's estate under sections 2036(a) and (c). The Court also denied the charitable contribution deduction. The estate only appealed the contribution deduction question to the 9th Circuit.

Over his life, Mr. Moore built a thriving and lucrative farm in Arizona. In September of 2004 he began negotiating its sale but fell into poor health. When he was released from the hospital and entered hospice care he began to plan his estate. He engaged the services of an estate planning attorney who came up with an incredibly complex plan, involving a combination of five trusts and a limited partnership. Mr. Moore decided to contribute most of his farm to the partnership, stating that he wanted to protect the farm from various business risks and bring his family together to learn to manage the business without him. But five days after the partnership received the ownership of the farm, Mr. Moore sold it. Even after the sale, Mr. Moore stayed on at the farm and directed its operations until he died.

When Mr. Moore first began meeting with his attorney, they discussed Mr. Moore's goals for his estate plan. The attorney wrote down the following goals:

(1) I would like to maintain my customary lifestyle.
(2) It is also important to me that the plan allow liquidity for emergencies and investment opportunities.

(3) I wish to maintain control of my assets during my life time. It is important that the plan reduce or eliminate federal estate taxes, if possible.

In order to meet these goals, the attorney set up a partnership, a charitable foundation and a series of trusts just four days after Mr. Moore was discharged from the hospital. Mr. Moore set up a living trust to which he transferred all of his real and intangible personal property, including his interest in the farm. Mr. Moore also created a charitable lead annuity trust, which would make donations to the Howard V. Moore Foundation, which would then contribute money to a community foundation. In the Living Trust Agreement, the amount that it would distribute to the charitable trust was defined a little bit oddly, not as a fixed sum or fixed amount, but as a fraction of the full value of the estate:

> The numerator is calculated as the smallest amount, which, when transferred to the Howard V. Moore Charitable Lead Annuity Trust, as provided in section 2 of the article, will result in the least possible federal estate tax being payable as a result of my death after allowing for the applicable exclusion amount (after taking into account adjusted taxable gifts, if any) as finally determined for federal state tax purposes, and the credit for state death taxes (but only to the extent that the use of this credit does not require an increase in the state death taxes paid).
>
> The denominator is the value of the living trust as determined for federal estate tax purposes.

During the trial, the attorney testified that the purpose of the charitable trust was to provide a vehicle through which Mr. Moore's children would be kept on speaking terms. Their work with the charitable trust would force them to meet periodically and make decisions about what charities would best promote the values of the family. At Mr. Moore's death, the remaining property in the living trust would be distributed to the Children's Trust.

The lynchpin of this plan was the Howard B. Moore Family Limited Partnership. The members of the family limited partnership were the Living Trust and Mr. Moore's children. After creating these five trusts and one limited partnership in only one day, Mr. Moore turned his attention to the sale of the farm, and within five days after contributing the farm to the Living Trust, which then contributed 4/5's of it to the family limited partnership, Mr. Moore closed on the sale. Based on these facts, the Court held that the assets, including the proceeds of the sale of the farm and the family limited partnership were included in Mr. Moore's estate under 2036.

After determining what was included in the decedent's estate, the Court then turned to what deductions the estate was entitled to. The Court noted that whether the living trust would get additional funds from the irrevocable trust to transfer to the charitable trust was not ascertainable at the decedent's death, but only after an audit by the IRS followed by a determination that additional property should be included in Moore's estate and followed by either the successful defense of that position or the estate acquiescence to the IRS's determinations. In other words, the Court said for the exception to apply, it would have had had been almost certain that the IRS would not only challenge but also be successful in that challenge of the value of the estate. The Court did not think that was a reasonable conclusion. Therefore, the Court denied any charitable deductions for the funds that might have been transferred to the charitable trust under the terms of the irrevocable trust.

The estate appealed the question of the charitable deduction, but the Court of Appeals for the 9th Circuit affirmed the tax court's holding. The Ninth Circuit noted that in order to determine whether the estate was entitled to a charitable deduction for the amount passing to the charitable trust, it much consider whether such donations were *required* under the trust document. The Court went on to note that the requirement to make a distribution to the Charitable Trust under the terms of the Irrevocable Trust was only triggered by a determination that any asset of the Irrevocable Trust was also an asset of the gross estate. Although the proceeds from the sale of the farm were included in the decedent's gross estate under Section 2026, they were assets of the limited partnership, not the trust. The Court held that the Trustee of the trust was therefore not required to transfer the sale proceeds to the Charitable Trust and the estate was not entitled to a charitable contribution deduction.

4. Smaldino v. Comm'r, T.C. Memo. 2021-127

This case involved the issue of indirect gifts. Over his lifetime, Petitioner had amassed a large fortune in real estate, approximately $80 million. After a health scare, Petitioner decided he needed to engage in estate planning. Petitioner's goal was to provide for his six children and ten grandchildren from a prior marriage. He also wanted to provide for his current wife.

Petitioner embarked on a plan to place some of his business holdings in an LLC and to gift interests in that LLC to a trust for the benefit of his children and grandchildren. Petitioner created an LLC whose sole member was a revocable trust. Petitioner was trustee of the revocable trust, and as such held all interest in the LLC and served as its manager. The LLC operating agreement ultimately stated the membership interest as 10 class A voting units and 990 class B nonvoting units.

Petitioner also created a trust for the benefit of his descendants (the "Dynasty Trust"). That same year Petitioner signed an assignment transferring to his wife a "sufficient number" of nonvoting units in the LLC so that the fair market value of those units was $5,249,118.42. Petitioner and his wife came to this figure because it was the amount of her then-remaining transfer tax exemption. The document was made effective April 14, 2013, but does not state the date it was actually signed.

Thereafter, Petitioner's wife transferred those same nonvoting units to the Dynasty Trust via an instrument with an effective date of April 15, 2013.

At the end of the day, the Dynasty Trust held 49% of the class B membership units. Petitioner hired an appraiser who determined the value of the 49% interest held by the Dynasty Trust was $6,281,000.

The LLC operating agreement provided that no transfer of membership units may be made to any person other than another member or a trust for the benefit of the issue of Petitioner. Further, the operating agreement was never amended to account for the transfer to Petitioner's wife, but was amended to show the Dynasty Trust's 49% ownership. Similarly, the LLC's tax return never showed Petitioner's wife as a member.

Petitioner filed a gift tax return reporting a $1,031,882 gift to the Dynasty Trust. He and his wife did not elect to split the gift. Mrs. Smaldino filed a gift tax return reporting a $5,249,118 gift to the Dynasty Trust.

The IRS issued a $1,154,000 notice of deficiency. The notice explained that the Petitioner had made over $8 million in taxable gifts; a $2,157,071 gift directly to the Dynasty Trust and a $6,022,929 gift indirectly through his wife.

The Court held that Petitioner never effectively transferred any membership interest in the LLC to his wife. The Court noted that it is "well established that the substance of a transaction, rather than the form in which it is cast, determines the tax consequences." The Court agreed with the IRS and accordingly treated all of the 49% class B membership interest transferred to Dynasty Trust as a gift from Petitioner. The Court reasoned that the substance of the transaction supported this position because: (i) Mrs. Smaldino was not a permitted transferee under the LLC operating agreement and the procedure to transfer membership interest to her was not followed; (ii) the LLC's tax return did not report Mrs. Smaldino as receiving a distribution or being a member at any time; (iii) Mrs. Smaldino testified she did not intend to retain the membership interests and transferred the interests to the Dynasty Trust one day after having received them; and (iv) the operating agreement of the LLC was not amended to reflect Mrs. Smaldino's membership interest; however, it was amended on the day after Petitioner transferred the interest to his wife to show the Dynasty Trust as holding a 49% membership interest.

5. Estate of Warne v. Comm'r, T.C. Memo 2021-17

This case involved the valuation of several closely-held business interests and the determination of the appropriate charitable contribution deduction allowable to the estate of Miriam Warne. Mr. and Mrs. Warne created the Warne Family Trust (the "Family Trust") in 1981. Over the years, the Family Trust became the majority owner in five LLCs, which in turn owned various real estate ventures.

In late December of 2012, Mrs. Warne gave fractions of the five LLS to her two sons and three granddaughters. Mrs. Warne died in February 2014. At the time of her death, the Family Trust owned 78%, 86.3%, 72.5%, 87.432% and 100% of the five LLCs. Under the ninth amendment to the Family Trust Agreement, Mrs. Warne left 75% of her interest in one LLC to the Warne Family Charitable Foundation and the remaining 25% to her church. Mrs. Warne's estate filed a gift tax return reporting gifts to her family and an estate tax return.

The IRS determined deficiencies for both the gift tax and estate tax. For the gift tax deficiency, the IRS determined a higher value for the gifts of the interests. For the estate tax deficiency, the IRS determined an increase in value of the LLCs, but also decreased the estate's charitable contribution deduction.

On the question of the charitable contribution deduction, the IRS argued that the Court should apply lack of control and lack of marketability discounts to the estate's donations to the Foundation and church. The IRS argued that the value of the deduction should reflect the benefit received by each recipient. The estate countered that the discounts were inappropriate and applying them would "subvert the public policy of motivating charitable donations." The estate argued that because 100% of the subject LLC went to charity, the estate should be entitled to a deduction for 100% of the value. The Court disagreed.

The Court noted that each party cited *Ahmanson Foundation v. U.S.*, 674 F.2d 761 (9th Cir. 1981) in support of its position. In *Ahmanson*, the decedent owned 100 shares in a corporation, one voting and 99 nonvoting. The decedent passed the one voting share to his son and the remaining 99 nonvoting shares to a charitable foundation. The Ninth Circuit held in that case that "[t]there is nothing in the statutes or in the case law the suggest that valuation of the gross estate should take into account that the assets will come to rest in several hands rather than one." In other words, when valuing an estate, the court will value the entire asset in the hands of the estate, regardless of where it eventually ends up.

But, the Court noted, when property is split as part of a charitable donation, a different principal applies. In that case "the valuation of these same sorts of assets for the purpose of the charitable deduction, however, is subject to the principal that the testator may only be allowed a deduction for estate tax purposes for what is actually received by the charity- a principal required by the purpose of the charitable deduction. In short, when valuing charitable contributions, we do not value what an estate contributed, we value what the charitable organization received." Therefore, the court held that while the estate must include 100% of the value of the LLC, it is only allowed a deduction of 75% of the value and 25% of the value for the donations to the respective charities. The Court then applied a 27.385% discount for the 25% interest and a 4% discount for the 75% interest.

6. Buck v. United States, 128 AFTR 2d 2021-6043 (D. Conn. Sept. 24, 2021)

In this District Court Case, the IRS claimed that a discount should not be available for a gift of a fractional interest unless the taxpayer held the interest in fractional form before the gift. The donor purchased $82,853,050 in tracts of timberland over several years and then gifted interests in those tracts to his two sons. Each son received a 48% interest in each tract and the donor retained a 4% interest for himself. The donor filed gift tax returns and paid gift tax on the transfers and utilized a discount in light of the fractional interests transferred to each son. The 55% discount resulted in total gifts of $36,992,498. The IRS challenged the donor's valuations and claimed that the donor could not take a fractional interest discount because he did not own a fractional interest immediately prior to the gift.

The IRS first tried to argue that the estate and gift tax must be read *in pari materia* and that a taxpayer may not use gifts to avoid the estate tax by making transfers of fractional interests in property to obtain a discount for gift tax purposes where the same property would have been valued without a discount for the purpose of the estate tax. The District Court discussed several cases supporting the *in pari material* rule of construction but found that that rule of construction is applied in estate and gift tax law to apply the same definitions and principles in each body of law. In other words, a term used for gift tax purposes is defined in the same manner as the term used for estate tax purposes. The District Court cited several cases where fractional discounts were both appropriate and allowable for gifts of this nature.

The IRS next tried to argue that the value of a gift for gift tax purposes is the value to the donor not to the donee. The District Court found that the value of ***a gift*** for gift tax purposes is the value at the time of the gift. The estate tax, however, looks at the value of ***all*** property held by a decedent at the time of death. So the gift tax values ***the gift*** and the estate tax values ***all*** property. The District Court found this distinction clear under the Treasury Regulations. The Tax Court proceeded to cite *LeFrak v. Comm'r*, T.C. Memo 1993-526 (1993), where a donor transferred minority interests in a partnership that owned underlying real estate. In *LeFrak*, the Tax Court recharacterized the gift as a gift of the underlying real estate and specifically found that the "fair market value of a fractional interest in real property cannot as a general rule be derived by simply applying the percentage of the interest in the whole to the value of the entire property," and proceeded to apply a minority discount and a discount for a lack of marketability "from the full value of each gift to each donee." Therefore, the District Court held under well establish precedent and applicable statutes and regulations, that the gifts here were of two 48% interests, not one 96% interest.

7. Nelson v. Comm'r of Internal Revenue, 17 F.4th 556, 559 (5th Cir. 2021)

In this case, the taxpayer made two transfers of limited partnership interests to a trust for the benefit of taxpayer's family. The IRS addressed whether the taxpayer transferred limited partnership interests equal to a fixed dollar amount or percentage interests.

The first transfer was a gift and the Memorandum of Gift and Assignment provided:

> [Mrs. Nelson] desires to make a gift and to assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 * * *, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.

The second transfer was structured as a sale and the Memorandum of Sale and Assignment provided:

> [Mrs. Nelson] desires to sell and assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 * * *, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment * * *.

Neither the memorandum of gift nor the memorandum of sale contained clauses defining fair market value or subjecting the limited partner interests to reallocation after the valuation date. After the time period required by each transfer document, the appraiser concluded that the transfers equated to the rounded amounts of 6.14% and 58.65% limited partner interests, respectively. Taxpayer and taxpayer's husband filed separate Forms 709 and they each reported the gift to the Trust "having a fair market value of $2,096,000 as determined by independent appraisal to be a 6.1466275% limited partner interest." They classified it as a split gift and reported that each spouse was responsible for half ($1,048,000). They did not report the second transfer of limited partner interest on their 2009 Forms 709, consistent with its treatment as a sale. The IRS issued notices of deficiency arguing the taxpayer transferred percentage interests of 6.14% and 58.65%, rather than fixed dollar amounts.

The Tax Court agreed with the IRS, holding that it must look to the transfer documents rather than subsequent events to decide the amount of property given away by a taxpayer in a completed gift. The Tax Court distinguished the case from previous defined value cases reasoning that the transferred interests were expressed in the transfer instruments as an interest having a fair market value of a specified amount as determined by an appraiser within a fixed period. The clauses hung on the determination by an appraiser within a fixed period; value was not qualified further, for example, as that determined for Federal estate tax purposes.

On appeal, the 5th Circuit again addressed whether the taxpayer transferred percentage interest or fixed dollar amounts.

The Fifth Circuit affirmed the decision of the Tax Court. The Fifth Circuit reasoned that most formula-clause cases featured transfer instruments that defined the interests transferred as the fair market value as determined for federal-gift or estate-tax purposes and that the instruments at issue did not. Specifically, the taxpayer defined the transfer differently; they qualified it as the fair market value that was determined by the appraiser. Once the appraiser had determined the fair market value of a 1% limited partner, and the stated dollar values were converted to percentages based on that appraisal, those percentages were locked, and remained so even after the valuation changed. The Fifth Circuit dismissed the taxpayer's argument that fixed dollar amounts were transferred because taxpayer's argument would require the court to give effect only to the first part of the transfer document (referencing fair market value) and not the second (referencing a qualified appraiser). The Court held that a reading did not comport with the plain meaning of the language used. The Fifth Circuit also noted that the transfer documents in every other formula-clause case contained crucial language that the subject transfer documents instruments lacked: specific language describing what should happen to any additional shares that were transferred should the valuation be successfully challenged.

8. Taylor Lohmeyer Law Firm – 957 F.3d 505 (5th Cir)

The IRS utilizes a John Doe summons when it does not know the identity of the taxpayers for whom it is trying to determine their tax liability. Issuing a John Doe summons first requires an *ex* *parte* court proceeding, in which the Government establishes: "(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons; (2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and (3) the information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources."

The IRS issued a John Doe summons which sought certain information related to a law firm's clients, including names, to investigate tax liability of those who allegedly used the firm to create and maintain foreign bank accounts and foreign entities to conceal taxable income. The investigation arose because, during the IRS's audit of one taxpayer, its investigation revealed that the taxpayer hired the law firm for tax planning, "which the law firm accomplished by (1) establishing foreign accounts and entities, and (2) executing subsequent transactions relating to said foreign accounts and entities." Specifically, the firm formed eight offshore accounts so the taxpayer could assign income to them, thereby avoiding U.S. income tax on the earnings. The taxpayer ultimately settled with the IRS, admitting to unreported income of over $5 million and an unpaid income tax liability of over $2 million. The taxpayer paid almost $4 million in tax, interest and penalties.

The law firm filed a motion to quash the summons on the basis that the summons was overbroad and an intrusion into the attorney-client relationship. The law firm claimed that despite the general rule, a lawyer's clients' identities are not covered by the privilege, an exception to that rule exists whereby "a client's identity is protected by the attorney-client privilege if its disclosure would result in the disclosure of a confidential communication," including the client's motive for seeking legal advice.

In siding with the IRS, the Court noted that precedent provides that this exception only "protect[s] the client's identity and fee arrangements in such circumstances not because they might be incriminating but because they are *connected inextricably* with a privileged communication—the confidential purpose for which [the client] sought legal advice."

The Fifth Circuit held that the law firm's clients' identities are not "connected inextricably with a privileged communication," and, therefore, the narrow exception to the general rule that client identities are not protected by the attorney-client privilege is inapplicable. The Fifth Circuit distinguished the facts from precedent in which the government knew the substance of the legal advice provided. The Fifth Circuit reasoned that the government sought relevant information about any U.S. client who engaged in any one of a number of the law firm's services, and that such request is not the same as the government's knowing whether any John Does engaged in allegedly fraudulent conduct, or the content of any specific legal advice the law firm gave particular John Does, and then requesting their identities.

Obviously, this ruling is very disconcerting for law firms. The American College of Tax Counsel filed an amicus brief, which was cited in the dissent, which included this warning:

> [T]he panel's decision could facilitate the issuance of John Doe summons to a law firm seeking documents identifying . . . any individual who engaged the firm for legal advice regarding structuring a family limited partnership or annuity trust. Departing from longstanding and established precedent in this and other circuits, the panel's decision subject the John Doe summons power to abuse by allowing the IRS to make broad requests to law firms to circumvent the privilege.

Note, on October 4, 2021, the United States Supreme Court denied certiorari.

9. Pinkert v. Schwab Charitable Fund (Case No. 20-cv-07657-LB)

In this case, the United States District Court for the Northern District of California dismissed claims against Schwab Charitable Fund ("Schwab Charitable") and Charles Schwab & Co. by a donor to a donor advised fund that Schwab Charitable Fund breached its fiduciary duty, that Charles Schwab aided and abetted the breach of fiduciary duty and that all defendants violated California's Unfair Competition Law. Specifically, the donor alleged that there were cheaper alternatives available for the index funds and that Schwab Charitable elected to use retail shares of some funds when it could have qualified for cheaper wholesale shares. The donor alleged that because Schwab Charitable failed to make more prudent and cheaper choices, fewer dollars were left in the donor's accounts that could be donated to charitable organizations in furtherance of the donor's charitable purposes. The defendants moved to dismiss the claims because, by contributing to the fund irrevocably in exchange for an immediate tax deduction, the donor relinquished control of the assets and did not suffer an injury.

Code Section 4966 defines donor advised funds and provides that when a donor contributes to a donor advised fund, the nonprofit sponsor takes legal title to the assets. The donor can direct how funds are invested and ultimately distributed to various charitable organizations. Further, a donor may obtain a charitable deduction for the contribution if the donor makes a completed gift and relinquishes dominion and control over the donated party. Schwab Charitable specifically advises donors that donations are "irrevocable and unconditional," that donations are subject to the exclusive legal authority and control of Schwab Charitable, donors cannot make donations subject to material conditions or restrictions and Schwab Charitable retains final authority over distribution of all grants.

Article III of the U.S. Constitution provides that a plaintiff has standing if (i) the plaintiff "suffered an injury in fact, [(ii)] that is fairly traceable to the challenged conduct of the defendant, and [(iii)] that is likely to be redressed by a favorable judicial decision." The plaintiff must show that the plaintiff suffered "an invasion of a legally protected interest that is concrete and particularized and actual or imminent, not conjectural or hypothetical." The District Court concluded that the donor here lacked standing under Article III because he gave up title to and control of his donation in exchange for an immediate tax deduction as provided in the statutory framework for donor advised funds and the underlying contractual relationship with Schwab Charitable. Further, there is no case law that supported the donor's claim that the right to designate investments and donations is a contractual right that conveys Article III standing.

Likewise, the District Court ruled that the plaintiff did not have standing to sue under the California law for what amounted to a breach of charitable trust. California law provides that the Attorney General has primary authority for supervising charitable trusts in California and ensuring compliance. Other than the Attorney General, the applicable statute "confers standing to file an action to enjoin, correct, obtain damages for or to otherwise remedy a breach of a charitable trust involving a public-benefit corporation only to (1) the corporation, (2) a member of the corporation acting in the name of the corporation, (3) a director or office of the corporation, or (4) a person with a reversionary, contractual or property interests in the assets." As discussed above, the donor did not have a reversionary, contractual or property interest in the assets and did not otherwise qualify for standing under the statute. Therefore, the case was dismissed.

10. Fairbairn v. Fidelity Investments Charitable Gift Fund (Case No. 18-cv-04881-JSC)

In a similar case, the United States District Court for the Northern District of California held in favor of Fidelity Investments Charitable Gift Fund ("Fidelity Charitable") regarding claims filed by the Fairbairns that Fidelity Charitable failed to uphold promises regarding the donation of stock to a donor advised fund and that Fidelity Charitable acted negligently in its sale of the contributed stock. The Fairbairns, wealthy and successful hedge fund managers, donated 1.93 million shares of stock in Energous (NASDAQ: WATT) to their donor advised fund at Fidelity Charitable. All of the donated WATT shares were sold on the afternoon of December 29, 2017, at a total fair market value of $52 million for proceeds of approximately $44 million, which resulted in a tax deduction of $52 million for the Fairbairns.

The Fairbairns alleged that Fidelity Charitable enticed them to donate the funds to a donor advised fund at Fidelity Charitable by promising (i) Fidelity Charitable would not trade more than 10% of the daily trading volume of WATT shares, (ii) Fidelity charitable would employ sophisticated, state-of-the-art methods for liquidating large blocks of stock, (iii) Fidelity Charitable would allow the Fairbairns to advise on a price limit and (iv) Fidelity Charitable would not liquidate any of the donated WATT shares until the new year. These alleged promises and the alleged failure to perform by Fidelity Charitable form the basis of the Fairbairns' claims that Fidelity Charitable is liable for common law misrepresentation, breach of contract, promissory estoppel and violating California's unfair competition law.

The District Court examined correspondence between the Fairbairns and Fidelity Charitable in the weeks leading up to the donation of the WATT shares to determine which of these promises, if any, were actually made by Fidelity Charitable. Of the alleged promises, the District Court found that the only promise supported by the facts was the alleged promise not to sell more than 10% of the daily trading volume of WATT shares. The District Court further found that Fidelity Charitable upheld this promise because its percentage of the trading volume on the day in question was only 6.7%. The Fairbairns unsuccessfully tried to recharacterize the promise as Fidelity Charitable promising not to have a participation rate greater than 10% at the time of trading but there was no evidence supporting this promise and the Fairbairns themselves had initially characterized the promise as only involving the percentage of the daily trading volume, not the participation rate. Further, the District Court held that even if the promises had been made, the Fairbairns could not have reasonably relied on the promises to donate the shares to their Fidelity Charitable donor advised fund as opposed to another organization because there was no more time left in the year for them to change to another institution. In other words, with the little time left in the year, Fidelity Charitable was their only option to be able to donate the WATT shares and obtain the desired charitable deduction for the tax year.

The Fairbairns also brought a claim against Fidelity Charitable for negligently liquidating the WATT shares in one day and, more specifically, the last few hours of the last trading day of the year. The District Court found that it was unclear whether Fidelity Charitable actually owed the Fairbairns a duty of care but ultimately determined that it was unnecessary to determine if a duty was owed because any such duty was not breached because Fidelity Charitable did not act negligently in its sale of the shares of stock. Specifically, the District Court found that (i) the liquidation was consistent with Fidelity Charitable's published policies regarding the liquidation of contributed stock which provided that it would be liquidated as soon as possible, and (ii) there was no evidence that a reasonably prudent donor advised fund would not have sold all shares under the market conditions that were present on the day of the liquidations.

11. Estate of Michael J. Jackson v. Comm'r, T.C. Memo 2021-48

In this case, the Tax Court was faced with determining the proper valuation of three assets owned by the late King of Pop, Michael Jackson: (i) Jackson's image and likeness; (ii) his interest in New Horizon Trust II, a bankruptcy trust that held an interest in Sony/ATV Music Publishing, LLC; and (iii) his interest in New Horizon Trust III, another bankruptcy trust that contained Mijac Music, a music publishing catalog that owned copyrights to compositions by Jackson and other songwriters.

Jackson began his career as a child and the lead singer of the Jackson 5 but soon exploded as a solo act both domestically and internationally. He continually shattered album and tour records during his career and *Thriller* remains the top-selling album in history. By many accounts, Jackson was the most well-known person in the world at the height of his career. His many successes, however, were cast under a shadow late in his life with allegations of child molestation and various other eccentricities. Following the allegations, Jackson became reclusive and no longer toured but continued spending as if he was at the height of his career and earnings, amassing an astronomical amount of debt to finance his lifestyle. Shortly before his death, Jackson began rehearsing for a comeback tour, the This Is It tour. His untimely death, however, caused the tour to be cancelled before the first show was performed. The Executors of his Estate faced the daunting proposition of satisfying $450 million of debt with assets of uncertain value in light of Jackson's lack of popularity late in his life. The Executors and the Estate's other advisors, however, proved incredibly successful in monetizing Jackson's legacy shortly after his death.

The Estate filed an estate tax return and the IRS responded with a deficiency notice and adjustments to valuations totaling more than $1 billion and additional tax due of a little more than $500 million. The IRS further added $200 million in accuracy related and other penalties. The Estate and the IRS negotiated settlements to the valuation of all of Jackson's assets other than the three items noted above, which were the focus of this case. The Tax Court reiterates case law that it must consider the fair market value of Jackson's assets as of the time of his death with the knowledge of facts present at his death as opposed to using hindsight. This proved particularly challenging in this case given Jackson's fame and fortune at the height of his career, the collapse of his public image later in life and the Estate's significant success in monetizing Jackson's legacy immediately after his death despite Jackson's poor public image immediately prior to his death. This case proved to be a battle of the valuation experts and much of the opinion is dedicated to analyzing the valuations presented by each party's experts.

In light of Jackson's tarnished public image in the decade prior to his death, the Estate's initial appraisal of his image and likeness resulted in a valuation of just $2,105, which is the value reported on the Estate's estate tax return. On audit, the IRS adjusted the value by $434,261,895. At trial, the Estate's valuation expert valued Jackson's image and likeness at just over $3 million and the IRS's expert valued Jackson's image and likeness at $161 million. The IRS's expert was caught in a lie during trial and the Tax Court found him generally unreliable. Notably, the IRS utilized the same expert for each of the assets at issue. The Tax Court ultimately found that the IRS's expert valued the wrong asset (he failed to focus specifically on image and likeness but instead valued entire categories of rights that would lead to film earnings and other revenues), included unforeseeable events in his valuation (he failed to appropriately take into account Jackson's tarnished reputation as of the date of his death and Jackson's inability to monetize his likeness in the years leading up to his death), and he miscalculated the asset's value (he failed to incorporate any expenses associated with the management of Jackson's image and likeness, including legal fees and public relations fees). The Tax Court ultimately held that the value of Jackson's image and likeness was $4,153,912.

The Estate reported the value of New Horizon Trust II as $0 on its estate tax return and the IRS issued an adjustment of $469,005,086. At trial, the Estate's expert valued the interest at $0 and the IRS's expert value the asset at $206,295,934. Jackson had purchased ATV Music Publishing Catalog, which contained at least 175 Beatles songs, in the 1980s and ultimately merged the catalog with Sony's publishing business to form Sony/ATV Music Publishing, LLC ("Sony/ATV"). Sony/ATV was owned one-half by Sony and one-half by Jackson. Towards the end of his lifetime, Jackson had borrowed $300 million against his interest in Sony/ATV. In light of Jackson's borrowing habits, Sony forced Jackson to sign various amendments to Sony/ATV's Operating Agreement that culminated in granting an option to Sony to buy one-half of Jackson's interest for a maximum stipulated price. Both the Estate's expert and the IRS's expert used the market and income approaches to value the asset. The Tax Court, however, found that the market approach was not appropriate because there were no similar transactions occurring at the time of Jackson's death to use in the valuation process. The Tax Court embarked on its own tax valuation using the income approach and ultimately determined that the value of the interest was negative in light of the amount of debt Jackson borrowed against his interest.

The Estate reported the value of New Horizon Trust III as $2,207,351 on the estate tax return and the IRS issued an adjustment of $60,685,944. At trial, the Estate's expert valued the interest at $2,267,316 and the IRS's expert valued the interest at $114,263,615. New Horizon Trust III owned Mijac Music, a music catalog that included (i) songs composed and performed by Jackson and released before he died, (ii) songs composed by Jackson but performed by someone else, (iii) major works by other artists, (iv) minor works by other artists and (v) songs composed and performed by Jackson that were not released prior to his death. This was the most difficult asset to value of the three assets analyzed at trial. The Tax Court was required to take into account each category of songs included in the catalog, the likelihood of releasing new music after Jackson's death (of which the number and quality of those found were called into question) and the unknown but likely magnitude of the spike in sales immediately following Jackson's death. The Tax Court found fault in the valuations provided by both parties' experts and determined that the value of New Horizon Trust III was $107,313,561.

The Tax Court further held that the penalties were not appropriate because although the Estate's valuations of the three assets at issue were lower than the Tax Court's final determination, the Estate reasonably relied on reputable appraisers and the valuations were reasonable in light of the unique circumstances surrounding Jackson at the time of his death (i.e., his tarnished reputation, his inability to generate merchandise sales, etc.).

Notably, the Tax Court also declined to tax effect the valuations in this case because it did not view it as necessary or certain that a C Corporation would be the purchaser of the assets in question. The Estate's experts had tax effected in its valuations but the IRS's expert had not.

12. Estate of Clara Morrissette v. Comm'r, T.C. Memo 2021-60.

This *Morrissette* case dealt with the question of inclusion and valuation of rights under split-dollar life insurance agreements.

Mr. and Mrs. Morrissette built a very successful moving company – growing from one used truck to a group of 32 companies operating moving, relocation and storage businesses. The Morrissettes had three sons, each of whom was involved in the business. For various reasons, however, the sons did not get along. Despite the animosity among their sons, Mr. and Mrs. Morrissette were intent on passing the business to them. Mr. Morrissette predeceased his wife.

In 2006, Mrs. Morrissette was diagnosed with Alzheimer's and dementia. Her sons were co-Trustees of her revocable trust and held a power of attorney for her. On her behalf, her sons embarked on a complicated estate planning scheme.

In 2006, Mrs. Morrissette's revocable trust created a dynasty trust for the benefit of each of her sons. Each son was the trustee of the trust for his benefit. The trust agreements for the dynasty trusts authorized the trusts to purchase insurance on the lives of the brothers, and required that the trusts be owners of the policies. The life insurance was intended to facilitate a buy-out of a deceased brother's shares in the family business pursuant to a renegotiated shareholders' agreement.

Also in 2006, each brother's dynasty trust purchased two universal life insurance policies – one on the life of each of the other two brothers. The policies had an initial death benefit of $1 million. Each policy also included a rider for additional death benefits of $8.73 million. Exercise of the rider would require additional premiums of approximately $5 million per policy, for a total of $30 million in premiums. The dynasty trusts exercised the riders.

Mrs. Morrissette's revocable trust entered into two split-dollar arrangement with each dynasty trust. A split-dollar arrangement is one between an owner and nonowner of a life insurance policy in which one party pays all or a portion of the premiums and is entitled to recover all or a portion of the premium from the proceeds of the life insurance policy. Under the split-dollar agreements, the revocable trust contributed the premiums for the insurance policies owned by the dynasty trusts. In return, the revocable trust was entitled to receive the greater of the amount of premiums it paid or the cash surrender value of the policy upon the insured's death or upon the termination of the split-dollar agreement. The parties to the split-dollar agreement could terminate them at any time by mutual agreement; however, the dynasty trusts had the power, <u>alone</u>, to cancel the policies and thereby end their obligations under the split-dollar agreements.

Mrs. Morrissette died in 2009. Her estate reported the fair market value of her revocable trust's rights under the split-dollar agreements as $7.49 million, despite the fact that she had paid approximately $30 million in premiums.

The IRS first argued that I.R.C §§ 2036 and 2039 applied to the transfer of the premiums to the dynasty trusts and that the value of the revocable trust's rights under the split-dollar agreements should be valued at least in the amount of the transferred premiums, or $30 million. Sections 2036 and 2038 both apply where a decedent has retained a right over transferred property. Section 2036 is designed to bring property over which a decedent retained an economic interest in the transferred assets back in to the decedent's gross estate. Section 2038 applies to transfers where the decedent has the right to alter, amend, revoke or terminate the transfer. However, both Section 2036 and Section 2036 are inapplicable to transfers that are bona fide sales. Therefore, if the transfers of the premiums by the revocable trust pursuant to the split-dollar agreements met the bona fide sale exception, they would not be included in Mrs. Morrissette's estate under either Section 2036 or Section 2038.

In order meet the bona fide sale exception, the transfer must (1) be for a significant and legitimate nontax purpose and (2) be for adequate and full consideration in money or money's worth. The Court held that the transfer of the premiums satisfied both of these prongs.

The Court held that there was a significant and legitimate nontax reason for setting up the split-dollar arrangements – to keep the business in the family and facilitate a smooth transition of ownership to the next generation. The Court noted that caselaw requires the "presence of a legitimate, nontax purpose; it does not require the absence of a tax saving motivation." The Court held that tax saving was not the primary motivation for this arrangement.

The Court also held that Mrs. Morrissette's revocable trust received adequate and full consideration for the transfer for the premium payments to the dynasty trusts. The Court refused the accept the IRS's argument that adequate and full consideration meant the exchange of assets of equal fair market value. The Court held the Mrs. Morrissette received benefits other than the simple financial benefits back to the trust.

The next question that the Court decided was whether the Section 2703 special valuation rule applied. Section 2703(a) provides that the value of any asset in a decedent's gross estate is determined without regard to (1) any option, agreement or other right to acquire the property for less than fair market value or (2) any restriction on the right to sell or use the property. Section 2703(b) provides an exception to this valuation rule where the restriction is a bona fide business arrangement, not a device to transfer property the decedent's family for less than adequate and full consideration, and comparable in terms other similar arm's-length agreements. The restriction at issue was the mutual termination provision under the split-dollar arrangements. The Court held, for reasons stated above, that the arrangement was a bona fide business arrangement. It also found that the split-dollar agreements were not devices to transfer assets for less than full and adequate consideration because they contained repayment terms that a reasonable investor would have accepted.

After three taxpayer wins on the Section 2036, 2038 and 2073 issues, the Court dealt a significant blow to Mrs. Morrissette's estate. In determining the fair market value of the split-dollar rights in Mrs. Morrissette's estate, the Court applied a maturity date of December 31, 2013 – three years after the estate tax return was filed. This was despite the fact that her sons had anywhere from a 14 to16-year life expectancy. The Court based this determination on the fact that each dynasty trust could cancel the policy and extinguish its obligations under the split-dollar arrangements (and indeed one son inquired about cancelling the policy only ten months after his mother's death). The Court also determined that from the outset of the split-dollar plan in 2006, there was an intent for the revocable trust to distribute the split-dollar contracts to the respective dynasty trusts at Mrs. Morrissette's death thereby cancelling any reimbursement obligation.

13. Estate of Simon Grossman vs. Comm'r, T.C. Memo. 2021-65.

In this recent Tax Court case, the Tax Court examined whether a surviving spouse of a decedent was a spouse for purposes of the estate tax marital deduction under Code Section 2056(a). Mr. Grossman was born in Germany in 1930 and spent most of his childhood in Poland. He and his family were Jewish, and many of his family members, including his parents, were killed in the Holocaust. Mr. Grossman himself was interned in various concentration camps during the war, but ultimately survived and immigrated to the United States around 1949.

Mr. Grossman's first wife, Hilda, was also Jewish. He and Hilda married in New York in 1955 and had two children together. Sometime in the mid-1960s, they separated and in 1965, they entered into a separation agreement that set out their respective property rights. After that 1965 separation, Simon and Hilda never reconciled.

By 1967, Mr. Grossman had begun a new relationship with Katia Equale, who was not Jewish. Mr. Grossman traveled to Mexico to obtain a divorce from Hilda and although Hilda did not appear or otherwise participate in the proceeding, a divorce was granted by the Mexican civil court in 1967. After Mr. Grossman obtained the Mexican divorce, he and Katia participated in a civil marriage ceremony in New Jersey and that relationship bore two children. By 1974, Mr. Grossman and Katia's relationship had ended, and in that year, his first wife, Hilda, filed suit in New York against Mr. Grossman and Katia, seeking a declaratory judgment that the Mexican divorce was null and void, and that she (Hilda) was Mr. Grossman's lawful wife. After a trial in 1976, the court held in Hilda's favor and determined that the marriage between Mr. Grossman and Hilda was not legally dissolved by a court of competent jurisdiction, and therefore the marriage between Mr. Grossman and Katia was null and void.

By 1986, Mr. Grossman became engaged to Ziona Grossman. Ziona was born and raised in Israel, and had dual United States/Israeli citizenship and was a resident of New York. Ziona's parents, siblings and family members still lived in Israel, and she and Simon decided to get married there.

Before his marriage to Ziona, Mr. Grossman asked Hilda to cooperate with him in the giving of a *get*, which is a religious divorce under rabbinical law. Simon and Hilda appeared before an Orthodox rabbinical court in New York, and obtained a *get*. That court issued a letter confirming that

Simon had obtained a Jewish divorce in a rabbi's presence and then confirmed in a second letter that Simon was Jewish and free to marry, according to Jewish law.

As part of their marriage registration process, Mr. Grossman and Ziona traveled to Israel and presented evidence of the *get* to the court in Tel Aviv. A rabbi from Tel Aviv signed a letter noting that the marriage was "allowed." Simon and Ziona were then issued a *ketubah* (marriage contract) permitting them to marry in Israel, which they did in 1987. They were married in a traditional Orthodox Jewish ceremony, at which time they completed and signed the *ketubah* and were issued a marriage certificate by the Israeli Ministry of Religious Services. The certificate noted that before entering the marriage, Ziona was single and Simon was divorced. After their marriage ceremony in Israel, the happy couple returned to New York and lived there until Simon's death in 2014. During those 27 years, Simon and Ziona lived together as husband and wife, had two children, and shared finances. Records also show that they filed their taxes and in Mr. Grossman's Will he directed that "any reference to my wife ... shall mean and refer to as Ziona Grossman and only to Ziona Grossman[.]"

During the period where Simon and Ziona were married, Hilda filed her returns as single and when Simon died in 2014, Hilda made no statutory claim against his estate as a surviving spouse.

During his life, Mr. Grossman had done very well for himself and at the time of his death, his estate was approximately $87 million. The bulk of his estate, $79 million, was bequeathed to Ziona. On the estate tax return, the estate claimed the marital deduction with respect to the assets that were bequeathed to Ziona.

The IRS mailed the estate a notice of deficiency reciting a $35,497,032 estate tax deficiency. The notice also determined an accuracy-related penalty under Code Section 6662 of a little over $7 million. Most of the adjustments in the notice were attributable to the IRS's determination that the Simon and Ziona were not married to each other for federal estate tax purposes, and thus Ziona did not qualify as Mr. Grossman's surviving wife within the meaning of Code Section 2056(a).

The Estate timely filed a petition to challenge the deficiency as determined by the IRS.

Holding for the Estate, the Tax Court noted that "the identification of a decedent's surviving spouse is a federal issue that should be determined by applying state law, typically, the law of the state where the decedent's estate is administered." The court went on to note that there is no dispute that Simon, Ziona and Hilda all resided in New York at all relevant times, that Simon died in New York, and the estate was being administered in New York. The IRS argued that because all parties were New York residents at all relevant times, the court must look to New York law "properly applied" to identify Mr. Grossman's surviving spouse. On the other hand, the Estate argued that an analysis under New York law was unnecessary, because the IRS was bound by certain Revenue Rulings that establish a "place of celebration" test to assess the validity of a marriage for federal tax purposes. Under this approach, Mr. Grossman's marriage to Ziona would be valid so long as it was valid in the place of celebration, i.e. Israel, without regard to the state where the parties lived. In making its ruling, the Tax Court analyzed both the rules that apply to marriages of Jewish persons under Israeli law and the rules of marriage under New York law.

The Tax Court noted that for purposes of Jewish religious law, a marriage can be dissolved only upon the death of one of the spouses or by means of divorce. A *get*, i.e. a religious divorce, is the only means of obtaining a divorce; a civil divorce has no effect on an individual's eligibility to remarry under Jewish religious law. If a Jewish person presents evidence of the *get* validly provided in another country under the supervision of that country's rabbinical courts, then Israel's rabbinical courts will recognize the *get*. Once Israel's rabbinical courts have confirmed that a Jewish couple satisfies the eligibility requirements, the couple is issued a *ketubah*, marriage contract. As noted above, Simon and Ziona both signed their *ketubah*.

The Tax Court went on to note that the identity of Simon's surviving spouse for federal estate tax purposes is a question to be decided under New York law. The IRS focused his analysis and Simon and Hilda's divorce, arguing that Hilda was the surviving spouse because she and Simon never validly divorced under New York law. The estate, on the other hand, looked first into Simon and Ziona's marriage. It maintained that Ziona was Simon's surviving spouse, because New York followed the place of celebration rule and there was no dispute that the marriage was valid in Israel, the place of celebration. The Tax Court agreed that the analysis should focus on Simon and Ziona's marriage and that the place of celebration rule controlled the outcome of this case. The Tax Court ultimately concluded that New York should respect Simon and Ziona's marriage under the place of celebration rule.

14. PLR 202107001 and PLR 202107002

These rulings involved the request of an extension of time to elect out of the generation skipping transfer tax exemption automatic allocation rules. In 2000, the taxpayer and his spouse established a family trust for the benefit of their issue. The family trust had GST tax potential. Also that year, the taxpayer established an irrevocable grantor retained annuity trust (GRAT). Under the terms of the GRAT, upon its termination, any remaining principal would pass to the family trust. Therefore, for GST tax purposes, the estate tax inclusion period with respect to a transfer to the GRAT closed on the date the GRAT terminated.

The family trust was created for the primary benefit of the children of taxpayer and spouse. Taxpayer did not intend for the trust to later provide benefits to potential grandchildren. The attorney who prepared the trust documents for taxpayer's spouse failed to advise them of the automatic allocation of GST exemption under Code Section 2036(c) and their ability to elect out of that automatic allocation on Form 709. As a result, the taxpayer's GST exemption was automatically allocated to his transfer to the GRAT at the expiration of the estate tax inclusion period. The taxpayer requested an extension of time to have the automatic allocation of GST exemption not apply. The service held that the taxpayer was entitled to relief under Treasury Regulations Section 301.9100-3 of the regulations because the taxpayer acted reasonably and in good faith, and that the grant of relief would not prejudice the interest of the government. The service granted the taxpayer a 120-day extension of time in which to make the election to opt out of the automatic allocation rules.

15. PLR 202107003

In this ruling, the IRS granted an extension of time to allow an estate to make a portability election. Under the facts of this ruling the decedent died, survived by a spouse. The decedent's estate was not required to file an estate tax return but should have filed the return in order to elect to allow the surviving spouse to use the unused portion of the decedent's applicable exclusion amount. For various reasons, the estate tax return was not timely filed and the portability election was not timely made. Upon discovering this the decedent's estate asked for an extension of time under which to make the portability election. The IRS granted the request for an extension but the ruling does not go into the facts which supported that ruling. The IRS only concluded that the requirements under section 301.9100-1 and 301.9100-3 of the regulations have been satisfied.

16. PLR 202116002, PLR 202116003 and PLR 202116004

In these Rulings, the IRS addressed the income, gift, estate, and GST tax consequences of a state court’s order correcting scrivener’s errors to resolve ambiguity in the trust terms.

Donor created a revocable trust for the benefit of Donor's Spouse and issue, amended such trust, and died prior to September 25, 1985. Article III of the trust agreement provided that upon the death of Spouse, the Trustees were directed to divide the assets of the trust and to establish as many separate trusts, equal in value, as there are children of the Donor who are then living or who are deceased, but leave issue at the time of Donor's death. The Trustees were directed to pay all income from each trust to the child living at the Donor's death and to the then living issue of a deceased child at least quarterly. In addition, the Trustees were permitted to make discretionary distributions of principal. Spouse subsequently died and the three separate trusts were created – one for each of Donor's children.

Article IV of the trust agreement provided that upon the death of Donor's children who survive him, the Trustees were to retain undistributed income and principal in trust under the same terms for the then living issue of the deceased child, per stirpes, until no great-grandchild of the Donor (who is descended from that child) is living under a specified age, at which point, the trust for that great-grandchild's share terminated and all undistributed income and principal were to be paid over outright and free from all trusts to that great-grandchild's then living issue by representation, if any, otherwise to Donor's issue, per stirpes, if any.

Article IV of the trust agreement contained ambiguities due to the following scrivener's errors: (i) it referred to trusts for a great-grandchild's share, but failed to provide direction to further divide a trust for Donor's child; (ii) it failed to indicate when a great-grandchild's share was to be established; (iii) it provided that the trust for each child was to terminate when the great-grandchild attained the specified age, at which point the Trustees were directed to distribute that great-grandchild's share to his or her living issue, rather than directly to that great-grandchild, who may still be alive at that point; and (iv) if any great-grandchildren, had no issue, the assets would be divided among Donor's issue, per stripes, which would cause property to be distributed to other family lines, even when there are still living descendants in that family line.

The Trustees asked the court for judicial construction to correct the scrivener's errors and resolve the ambiguities. Donor's three children executed affidavits swearing that was each of their understanding that Donor intended that trust property be held in trust for future generations, to divide into separate trusts for each grandchild (not great-grandchild) upon a child's death, and to benefit a child's family line as long as there were descendants living in that family line. Furthermore, it was their understanding that the separate trusts were intended to terminate on the deaths of Donor's grandchildren and to be paid out to great-grandchildren. The court issued an order and amended the trust as requested.

Treasury Regulations Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the GST provisions if: (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state. The Supreme Court of State has ruled that a court may require a trust to be reformed on clear and decisive proof that the instrument fails to embody the settlor's intent because of scrivener's errors. To ascertain the settlor's intent, a court looks to the trust instrument as a whole and the circumstances known to the settlor on execution. In addition, courts may accept extrinsic evidence, such as an attorney's affidavit, that demonstrates that there has been a mistake.

The IRS ruled that the Trust would not lose its grandfathered GST-exempt status or cause distributions from Trust or terminations of interests in Trust to be subject to the GST tax. The IRS reasoned that an examination of the relevant Trust instruments, affidavits, and representations of the parties indicate that Donor intended that Trust property be held in trust for future generations, to be divided into separate trusts for each grandchild upon a child's death, and the court's amendment does not constitute the exercise by Donor of any right to an interest in Trust or control over Trust property.

For the same reasons, the IRS ruled that the court's order would not cause any beneficiary to be treated as making a taxable gift nor would any portion of the Trust be includible in the gross estate of any beneficiary prior to its termination. Lastly, the IRS ruled that because there was no sale or disposition of property and the beneficiaries would possess the same interests before and after the court's order, neither the Trust nor its beneficiaries would recognize any gain or loss from sale or other disposition of property.

17. PLR 202116001

In PLR 202116001, the IRS addressed whether the division of a QTIP trust and distribution of its assets pursuant to a court order resulted in a taxable gift under Code Sections 2519 or 2511.

Decedent died survived by Spouse, Daughter 1, and Daughter 2. Decedent's Will created a Marital Trust, referred to herein as Qualified Trust. Section 3.1 provided that Spouse was the income beneficiary of Qualified Trust for life and, at Spouse's death, the original and substitute principal beneficiaries would become income beneficiaries in proportion to their interests in principal. Section 3.2 provided that the original principal beneficiaries of Qualified Trust were Daughter 1 and Daughter 2. Section 3.2 provided further that should either of the original principal beneficiaries die both intestate and without decedents, then the original principal beneficiary who survives her would become substitute beneficiary of her interest. Article V provided that Qualified Trust would terminate upon the death of the last surviving income beneficiary. However, at any time *after Spouse's death*, the Qualified Trust could be terminated as to a beneficiary's interest and any part of the trust property representing her interest could be distributed to that beneficiary if the trustee considered such distribution to be in the best interests of the beneficiary. Article VII, section 7.1.2 provided that during Spouse's lifetime income accruing to Qualified Trust would be distributed to Spouse at least monthly. On Decedent's estate tax return, Decedent's estate elected to treat Qualified Trust as qualified terminable interest property.

Trustee divided Qualified Trust into two trusts, Qualified Trust-A and Continuing Qualified Trust, both with terms and provisions identical to those set forth in Qualified Trust. Then Trustee and the beneficiaries of Qualified Trust-A petitioned Court for an order with respect to Qualified Trust-A. Finding that a continuation of Qualified Trust-A unchanged would defeat or substantially impair its purposes, Court entered Order modifying the terms and provisions of Qualified Trust-A. Specifically, the Order modified the terms of Qualified Trust-A to provide that Qualified Trust-A would terminate upon the death of the last surviving income beneficiary, and that at any time, *including prior to Spouse's death*, Qualified Trust-A may be terminated as to a beneficiary's interest.

Section 25.2519-1(c)(1) provides that the amount treated as a transfer under Code Section 2519 upon a disposition of all or part of a qualifying income interest for life in QTIP property is equal to the fair market value of the entire property subject to the qualifying income interest, determined on the date of the disposition, less the value of the qualifying income interest in the property on the date of the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under Treasury Regulations Section 25.2511-2.

The IRS ruled that the division itself did not cause the assets remaining in Qualified Trust after the division (referred to as Continuing Qualified Trust) to be subject to gift tax under Code Sections 2519 or 2511. The IRS reasoned that upon division, the terms of the resulting trusts were identical to those set forth in Qualified Trust and that the beneficial interests of Spouse, Daughter 1, or Daughter 2 did not change.

In contrast, the IRS held that the Order changed the beneficial interests of Spouse, Daughter 1, and Daughter 2 because the Order provided that at any time, *including prior to Spouse's death*, Qualified Trust-A may be terminated as to a beneficiary's interest. In other words, the Order terminated Spouse's income interest. Accordingly, the IRS ruled that Spouse was deemed to have made a transfer of all of the property in Qualified Trust-A under Code Section 2519, other than the value of her qualifying income interest, and Spouse was deemed to have made a transfer of her qualifying income interest in Qualified Trust-A under Code Section 2511, upon entry of the Order approving modifications by which the income interest of Spouse in Qualified Trust-A was terminated and distributions from Qualified Trust-A were permitted to be made prior to death of Spouse.

18. PLR 202116006

In PLR 202116006, the IRS granted relief to the estate of a surviving spouse by allowing the surviving spouse's GST exemption to be allocated after the federal estate tax return had been filed.

Husband and Wife established Trust for the benefit of the surviving spouse and their descendants. Husband died and pursuant to the terms of the Trust, the trustee of Trust divided Trust into two separate trusts designated as the Survivor's Trust and the Residual Trust, and further divided the Residual Trust into two separate trusts designated as the Credit Shelter Trust and the Marital Trust. A QTIP election was made for the Marital Trust on Husband's Form 706, but no reverse QTIP election was made. Accordingly, Husband's GST exemption was not allocated to Marital Trust. Wife subsequently died survived by her three children and grandchildren. The value of the Survivor's Trust and the Marital Trust exceeded Wife's remaining GST exemption. Thus, pursuant to the terms of Trust, the Marital Trust and the Survivor's Trust were divided into separate exempt and non-exempt trusts: Child's Exempt Trusts and Child's Non-Exempt Trusts, to benefit Wife and each respective child and that child's issue. The trustees instructed Accounting Firm to prepare a Form 706 for Wife's estate. Accounting Firm failed to prepare and include a Schedule R (Generation-Skipping Transfer Tax) with the Form 706. Accordingly, Wife's GST exemption was not affirmatively allocated to Child's Exempt Trusts on the Form 706. The error was discovered and Wife's estate requested an extension of time to allocate Wife's GST exemption to the Child's Exempt Trusts.

Treasury Regulation Section 26.2632-1(d)(1) provides that an allocation of a decedent's unused GST exemption by the executor of the decedent's estate is to be made on Form 706 filed on or before the date prescribed for filing the return (including extensions). Notice 2001-50, 2001-2 C.B. 189, provides that, under Code Section 2642(g)(1)(B), the time for allocating the GST exemption to lifetime transfers and transfers at death, is to be treated as if not expressly prescribed by statute and taxpayers may seek an extension of time to make an allocation described in Code Section 2642(b)(1) or (b)(2) under the provisions of Treasury Regulation Section 301.9100-3. Requests for relief under Treasury Regulation Section 301.9100-3 will be granted when the taxpayer provides the evidence to establish that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government. Treasury Regulation Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Because the executors of Husband's estate did not make a reverse QTIP election with respect to Marital Trust on Husband's Form 706, under Code Section 2044 and Treasury Regulation Section 26.2652-1(a)(1), Wife was deemed to be the transferor of the Marital Trust for GST purposes. In addition, Wife was the transferor of the Survivor's Trust. Pursuant to the term of the Trust, these trusts were divided into Child's Exempt Trusts and Child's Non-Exempt Trusts. The IRS ruled that the requirements of Treasury Regulation Section 301.9100-3 were satisfied. Accordingly, the executors of Wife's estate were granted an extension of time until 120 days after the ruling to allocate Wife's GST exemption to Child's Exempt Trusts.

19. PLR 202115002

In PLR 202115002, the IRS granted decedent's estate's request for an extension of time to make a qualified terminable interest property election. The decedent's will provided that the entire trust estate was to be held in a Marital Trust for the benefit of the surviving spouse, with all income payable to the surviving spouse. The Trustee has the authority to elect make a QTIP election under Code Section 2056(b)(7). The surviving spouse hired an estate tax attorney and a CPA firm but was not advised to file a Form 706. The CPA firm subsequently prepared a Form 706 to make a portability election but did not make the appropriate QTIP election. The IRS determined that the decedent's estate acted reasonably and in good faith in relying on professional advisors and that the government's interests would not be prejudiced by granting the extension request. Therefore, the IRS granted an extension of 120 days from the date of the ruling to make the QTIP election for the Marital Trust.

20. PLR 202117001

In this letter ruling, the taxpayer requested an extension to allocate his gift exemption to two trusts. The taxpayer created and funded a revocable trust during his lifetime. At his death, the trust became irrevocable and was divided into a family trust and a marital trust. The marital trust was further divided into an exempt marital trust and a non-exempt marital trust. Each of the family trust, the exempt marital trust and the non-exempt marital trust had GST potential. The spouse of the decedent served as executor of her husband's estate and hired an attorney and an accountant to help with the administration of the estate. The executor was advised of the ability to affirmatively allocate GST exemption to the family trust and the exempt marital trust. However, the accountant inadvertently failed to timely file the application of extension of time to file the estate tax return. The accountant discovered the error when preparing the decedent's estate tax return and filed the return prior to what would have been its extended due date, had an extension actually been obtained. The decedent's executor requested of an extension of time to allocate decedent's GST exemption to the family trust and the exempt marital trust.

The IRS determined that the taxpayer was entitled to relief under Treasury Regulation Section 301.9100-1(c) because she acted reasonably and in good faith. The IRS noted that a taxpayer is deemed to have acted reasonably in good faith if he or she reasonably relied on a qualified tax professional and the tax professional failed to make revise the taxpayer to make the election.

21. PLR 202120003

In this ruling, the IRS granted decedent's estate's request for an extension of time to file a Form 706 for the purpose of making a portability election under Code Section 2010(c)(5)(A). The decedent's estate represented that decedent's spouse survived the decedent, decedent's estate was not required to file an estate tax return under Code Section 6018(a), the decedent had unused exemption amount remaining and a portability election was required to enable the surviving spouse to utilized the decedent's DSUE amount at the surviving spouse's death. The IRS determined under Treasury Regulation Section 301.9100-1(c) that the decedent's estate acted reasonably and in good faith and granting relief would not prejudice the interests of the government. Therefore, the IRS granted an extension of time of 120 days from the date of the ruling to make the portability election. *See also* PLR 202115001 (April 16, 2021), PLR 202116005 (April 23, 2021), PLR 202120002 (May 21, 2021), and PLR 202120007 (May 21, 2021).

22. Summary of Recent Transfer Tax Proposals

President Biden's Campaign Proposals. President Biden campaigned on the promise of widespread tax policy changes that would "require corporations and the wealthiest Americans to finally pay their fair share." President Biden campaigned on the promise that taxpayers with income less than $400,000 per year would not pay additional tax and that most middle-class Americans would actually experience additional tax cuts and credits under his tax plan. Despite this purported benefit to the middle-class, it is clear that President Biden's plan intends to increase taxes in a variety of ways for wealthy individuals. Highlights of President Biden's tax plan are included below.

Individual Income Tax Proposals. President Biden's tax policy proposes the following changes to individual income taxes:

- Increase the top individual income tax rate from 37% to 39.6%;
- Repeal the tax cuts from the TCJA for taxpayers with annual income exceeding $400,000;
- Tax capital gains of individuals with annual income exceeding $1,000,000 at the ordinary income rate rather than the preferential capital gains rate;
- Tax unrealized capital gains on assets held by individuals at death;
- Expand the child and dependent care credit by increasing the amount of covered expenses, increasing the phase-out threshold to $125,000 and making the credit refundable;
- Expand (temporarily) the child tax credit to $3,600 for a child under age six and $3,000 for other children under age 17 and make the credit refundable;
- Limit itemized deductions for taxpayers with annual income exceeding $400,000 to 28%;
- Create a refundable tax credit of $15,000 for down payments for first time homebuyers;
- Require the payment of Social Security earnings that exceed $400,000;
- Eliminate step-up in basis; and
- Phase out qualified business income deduction for taxpayers with annual income exceeding $400,000.

Business Income Tax Proposals. President Biden's tax policy proposes the following changes to business income taxes:

- Increase the top corporate income tax rate to 28% (from 21%);
- Require a minimum 15% tax on book income for corporations with book profits exceeding $100,000,000;
- Introduce a 10% surtax on sales of goods produced abroad and sold domestically;

- Require a country-by-country minimum 21% tax on earnings of foreign subsidiaries (this results in a doubling of the Global Intangible Low Tax Income currently in effect);

- Create new incentives to encourage domestic production of certain "critical" products;

- Expand tax deductions for energy efficient upgrades in commercial buildings;

- Introduce a tax credit to cover 50% of a business's cost to construct a child care center for employees (up to $1,000,000); and

- Create a tax penalty for pharmaceutical companies when they increase the costs of drugs by more than the inflation rate.

Transfer Tax Proposals. It is assumed that President Biden's tax policy proposes to restore the estate and gift tax rate and exemptions to 2009 levels. This would result in a top estate tax rate of 45% and an exemption of $3,500,000. Note that President Biden's campaign website did not address the estate tax and that President Biden did not officially indicate his exact plans for the estate tax. Many have assumed his plans would mirror those of President Obama. Accordingly, any actual proposal by President Biden may differ from those assumed here. No mention has been made of the generation-skipping tax, but one can logically assume that unless it is fully decoupled from the estate and gift tax, it will continue to mirror the provisions of the estate and gift tax.

Other Proposals and Potential Changes Prior to 2021. In addition to the changes proposed by President Biden, other congressional leaders and political candidates have espoused other changes in the tax code. The changes discussed below are quite progressive but indicate what some individuals in Congress are willing to enact. A few of these are briefly described below.

For the 99.8 Percent Act. Senator Sanders introduced the For the 99.8 Percent Act to modify provisions regarding the estate, gift and generation-skipping taxes. Although Senator Sanders was unsuccessful with his presidential bid, his policy proposals have become more popular over the past few years and more congressional leaders support similar policy changes. As an illustration, the proposed legislation would make the following changes:

- Increase the estate tax rate to 77% for estates that exceed $1 billion;

- Reduce the basic exclusion amount to $3,500,000;

- Require consistent basis reporting for gifts and transfers to trusts;

- Limit availability of discounts for business interests; and

- Require Grantor Retained Annuity Trusts ("GRATs") to have a minimum term of ten years and a minimum remainder interest value equal to the greater of 25% of the fair market value of the trust property or $500,000.

Wealth Taxes. Senator Sanders and Senator Warren proposed wealth taxes as part of their campaigns. These proposals are briefly summarized below.

Senator Sanders's Wealth Tax. A brief summary of Senator Sanders's wealth tax is as follows:

- The wealth tax would impose a 1% tax on net worth above $32 million for a couple. The tax rate would gradually increase to 8% on wealth over $10 billion.

- The wealth tax would target the wealthiest 180,000 households in America that make up the top 0.1%.

- The wealth of billionaires would be cut in half over fifteen years.

- The wealth tax would allow periodic rather than annual appraisals for the purpose of the tax. Those who elect periodic appraisals would be subject to an average rate of inflation in the intervening years.

- Assets placed in a trust would be treated as owned by the grantor until the grantor's death.

Senator Warren's Wealth Tax. Senator Warren's wealth tax proposed the following:

- A 2% annual tax on net worth between $50 million and $1 billion.

- A 4% annual surtax on net worth above $1 billion.

- A deferral of payment for up to five years with interest.

- A 40% exit tax on net worth over $50 million of any U.S. citizen who renounces citizenship.

Note: proposal would result in an heir with a net worth of $20 billion having a total annual liability of $1.16 billion.

Proposals Introduced in 2021.

For the 99.5 Percent Act. Senator Sanders introduced a revised version of his prior bill on March 25, 2021. The "For the 99.5 Percent Act" is very similar to the original to the original bill and provides for the following proposals:

- Increase the estate tax rates with a highest rate of 65% (effective for tax years beginning after December 31, 2021);

- Reduce the estate tax basic exclusion amount to $3,500,000 million (effective for tax years beginning after December 31, 2021);

- Reduce the gift tax exemption amount to $1,000,000 (effective for tax years beginning after December 31, 2021);

- Provide that there is no step-up in basis for certain grantor trusts that are not included in the grantor's estate (effective for transfers occurring after the date of enactment);

- Limit the use of valuation discounts, including minority discounts, for closely-held entities commonly used for estate planning purposes (effective for transfers occurring after the date of enactment);

- Require GRATs to have a minimum term of ten years and a maximum term of no more than the annuitant's life expectancy plus ten years (effective for transfers occurring after the date of enactment);

- Require GRATs to have a remainder interest at least equal to the greater of twenty-five percent of the fair market value of the trust or $500,000 (effective for transfers occurring after the date of enactment);

- Treat grantor trusts as includible in the estate of the grantor and transfers to grantor trusts as incomplete gifts until such time as the distributions are made from the trusts or grantor trust status terminates (effective for transfers occurring after the date of enactment);

- Apply the generation-skipping tax to trusts lasting more than fifty years (effective for transfers occurring after the date of enactment); and

- Limit the use of the gift tax annual exclusion for certain transfers, including limiting the total transfer per donor in a calendar year to twice the annual exclusion for transfers in trust (effective for transfers occurring after the date of enactment).

Representative Pascrell's Proposal. Representative Pascrell introduced a bill on March 29, 2021, that specifically seeks to end the step-up in basis. Specifically, the bill proposes the following:

- Treat transfers of property by gift or at death as a deemed realization event except for transfers to a spouse or to a charity and except for transfers of certain tangible personal property;

- Provide that a transfer to a grantor trust is not a realization event and the deemed realization event does not occur until the grantor is no longer treated as the owner of the property;

- Create a deemed realization event for transfers to non-grantor trusts;

- Provide for a deemed realization event for trust assets every thirty years, which the earliest recognition event being January 1, 2022;

- Create a $1,000,000 exemption for transfers at death (indexed for inflation);

- Require information reporting for deemed realization events in a manner similar to estate tax regulations governing the use of Form 8971.

Sensible Taxation and Equity Promotion Act. Senator Chris Van Hollen proposed his Sensible Taxation and Equity Promotion Act (the "Step Act") on March 29, 2021. The STEP Act proposed the following challenges to existing law:

- Treat transfers by gift, bequest or to a non-grantor trust as deemed realization events;

- Include the following rules for transfers with trusts;

    - Providing that transferring property to or from a grantor and a grantor trust is not a realization event;

    - Providing that a realization event occurs when property is transferred to another person, the grantor dies or grantor trust status terminates;

    - Providing that property is deemed sold to a grantor trust if the trust would not be included in the grantor's estate;

    - Creating deemed realization events for trusts every twenty-one years, with the first realization event occurring in 2026;

- Include exceptions for transfers to spouses and charities;

- Provide the recipient of a transfer that is a deemed realization event receives a basis equal to the FMV of the property at the time of the transfer;

- Provide a $1,000,000 exclusion for gains at death and the option to use $100,000 of the exclusion during the individual's lifetime;

- Allow deduction for appraisal costs for transferred property subject to the new rules;

- Allow for extension of time to pay tax for certain illiquid assets.

The changes proposed in the STEP Act would be retroactive to January 1, 2021.

The American Families Plan. The White House introduced the American Families Plan via a fact sheet released on April 28, 2021. The American Families Plan proposes the following changes to existing law:

- Create a comprehensive paid family and medical leave program;

- Extend the Child Tax Credit, the Earned Income Tax Credit and he Child and Dependent Care Tax Credit;

- Increase reporting requirements for financial institutions to ensure that the wealthy pay their fair share of taxes;

- Increase IRS funding to bolster enforcement of tax laws against those making more than $400,000 in income;

- Restore the highest tax rate to 39.6% (from 37%);

- Require households making over $1,000,000 to pay tax on capital gains using a 39.6% rate;

- End step-up in basis for gains in excess of $1,000,000 ($2.5 million per couple, including existing real estate exemptions);

- Subject carried interest to ordinary income rates; and

- Limit 1031 exchanges to gains of $500,000.

Interestingly, the American Families Plan does not discuss any changes to the estate, gift or generation-skipping transfer taxes.

Green Book. The U.S. Department of Treasury released its "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals" (the "Green Book") in May 2021. The Green Book proposes the following changes:

- Increase top marginal tax rate to 39.6% for income over $509,300 for married individuals or $452,700 for unmarried individuals (effective for tax years after December 31, 2021);
- Apply the highest ordinary income tax rate to capital gains for taxpayers whose income exceeds $1,000,000 (effective for gains realized after the date of the announcement, which is presumed to be April 28, 2021);
- Treat a transfer by gift or at death as a realization event subject to capital gains tax (effective for tax years after December 31, 2021);
- Require trusts to pay tax on unrealized gain if the property has not been the subject of a realization event in the prior ninety years, with the earliest realization event occurring on December 31, 2030 (effective for tax years after December 31, 2021);
- Treat transfers of property into and out of trusts as realization events (effective for tax years after December 31, 2021);
- Apply a $1,000,000 per-person exclusion on the realization of capital gain at death or by gift transfer with the ability to port unused exemption (effective for tax years after December 31, 2021);
- Tax carried interest income at ordinary tax rates for individuals with income in excess of $400,000 (effective for tax years after December 31, 2021); and
- Limit 1031 exchanges to real estate transactions with gain up to $500,000 for individual taxpayers or $1,000,000 for married individuals filing a joint return (effective for tax years after December 31, 2021).

House Ways and Means Committee Proposal. The House Ways and Means Committee introduced its tax plan proposal on September 14, 2021. Relevant provisions included:

- Reduction of unified credit against estate and gift taxes to its 2010 level of $5,000,000 per individual, indexed for inflation.
- Inclusion grantor trusts in the grantor's taxable estate. This would apply to trusts created after enactment and to transfers to existing trusts after enactment.
- Deemed sale treatment for sales between grantor and grantor trusts
- Limitation on valuation discounts for "nonbusiness assets"
- Increase maximum corporate tax rate to 26.5%

- Increase maximum individual tax rate to 39.6% (would apply to single individuals earning over $400,000, and to married couples filing jointly earning over $450,000).

- Increase in capital gains Rate for certain high-income individuals to 25%

- 3 % Surcharge on income over $5,000,000. This surcharge also applies to trusts and estates.

Retroactivity of New Legislation. Many practitioners and advisers are concerned about the prospect of retroactive tax legislation—particularly the retroactive application of a lower lifetime estate and gift tax exemption to any transfers occurring after January 1. Precedent exists for retroactive tax legislation, but many practitioners believe that retroactive tax legislation is unlikely to occur. Those practitioners cite the inherent unfairness of such legislation, the public policy against such legislation, and the inability for individuals to adequately complete tax planning when faced with retroactive laws as the basis for the skepticism. It is impossible to say now, however, whether any new legislation will be made retroactive although the STEP Act would be made retroactive to January 1, 2021, if enacted into law. It is certainly a possibility and an adviser's job is to counsel a client against the risks of making a gift today in light this unknown. The safest course is likely to prepare for year-end gifts and wait to see if any legislation is discussed or enacted this year prior to implementing the prepared plans. Some clients, however, may feel that they need to make gifts earlier this year in light of business transactions anticipated mid-year.