2023 TRUST ADVISORS FORUM

HOT TOPICS IN ESTATE PLANNING

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Table of Contents

1) Current Tax Law – 2023 Updates

Much of the current individual and corporate tax law in the United States was created by the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, and effective beginning January 1, 2018 (the "TCJA"). The TCJA has been widely heralded as a significate accomplishment by the Trump Administration and lauded by many in the wealthy and business classes who have largely benefited from higher transfer tax exemptions and lower income tax rates. Because the TCJA was passed using the Byrd Rule and in light of the national budget concerns attendant to major tax policy legislation, most of the individual tax reform provisions will sunset on December 31, 2025, which will bring many of the pre-TCJA rates and exemptions back into effect immediately on January 1, 2026. Many of the business tax reform provisions, however, were made permanent (or as permanent as legislation can be).

a) ***Income Tax***.

i) ***Taxation of Individuals***. The provisions of the TCJA significantly affected individual income taxation for wealthy clients. As many advisers have become acutely aware over the past decade, income tax planning has become more of a significant part of planning for clients and is considered more often when selecting and implementing estate planning strategies. Accordingly, a knowledge of income tax is important for all advisers, even for those whose roles have been traditionally limited to other areas, such as transfer taxes. A high-level summary of the current provisions impacting clients is included below.

(1) ***Income Tax Rates***. The TCJA significantly modified the income tax brackets for individuals. Most significantly, the TCJA reduced the highest tax rate to 37%. The income tax brackets for single individuals and married individuals filing jointly for 2023 are as follows:[2]

Single Individuals	
Amount of Income	**Tax Rate**
Not over $11,000	10%
Over $11,000 but not over $44,725	12%
Over $44,725 but not over $95,375	22%
Over $95,375 but not over $182,100	24%
Over $182,100 but not over $231,250	32%
Over $231,250 but not over $578,125	35%
Over $578,125	37%

[2] Rev. Proc. 2022-38, 2022-45 I.R.B. 445.

Married Individuals Filing Jointly	
Amount of Income	**Tax Rate**
Not over $22,000	10%
Over $22,000 but not over $89,450	12%
Over $89,450 but not over $190,750	22%
Over $190,750 but not over $364,200	24%
Over $364,250 but not over $462,500	32%
Over $462,500 but not over $693,750	35%
Over $693,750	37%

(2) ***Capital Gains Rates***. The TCJA also altered the manner in which capital gains are taxed. Prior to the adoption of the TCJA, capital gains rates were determined based on a taxpayer's income tax bracket. Under the TCJA, however, capital gains rates are based on a taxpayer's income level. The capital gains rates for single individuals and married individuals filing jointly for 2023 are as follows:[3]

Single Individuals	
Amount of Income	**Tax Rate**
Not over $44,625	0%
Over $44,625 but not over $492,300	15%
Over $492,300	20%

Married Individuals Filing Jointly	
Amount of Income	**Tax Rate**
Not over $89,250	0%
Over $89,250 but not over $553,850	15%
Over $553,850	20%

(3) ***Standard Deduction***. The TCJA increased the standard deduction significantly in an effort to simplify the tax filing process for a majority of taxpayers. In 2023, the standard deduction under Code Section 63(c)(2) is $13,850 for a single individual and is $27,700 for married individuals filing jointly.[4] The increased standard deduction has resulted in more taxpayers taking the standard deduction rather than itemizing.[5]

(4) ***State and Local Tax Deduction***. The deduction for state and local taxes was reduced to $10,000 per taxpayer by the TCJA.[6] This

[3] *Id*.
[4] *Id*.
[5] *See* Individual Income Tax Returns Complete Report 2018 (IRS Publication 1304 – Rev. 9-2020), 22, https://www.irs.gov/pub/irs-pdf/p1304.pdf#page=22. The 2018 tax report indicates that 87.3% of tax returns claimed a standard deduction in 2018—up from 68.9% in the prior year.
[6] 26 U.S.C.A. § 164(b)(6) (Westlaw through P.L. 116-258). This provision will sunset effective December 31, 2025.

limitation created significant challenges for taxpayers in high tax states and limited the ability to fully deduct local taxes. Note that this limitation does not apply to real and personal property taxes paid in carrying on a trade or business. The introduction of this limitation led to some states concocting schemes purported to allow taxpayers to contribute a portion of the taxpayer's local tax to a charitable fund established by the state, for which the taxpayer would receive a credit for taxes paid and, purportedly, a federal income tax charitable deduction in lieu of the state and local income tax deduction.[7] A recent development regarding state and local taxes is that the IRS has indicated it intends to approve a more recent strategy introduced by a few states that enable a pass-through entity to elect to pay an entity-level state tax that results in an offsetting credit against the owners' individual income taxes.[8]

ii) ***Taxation of Business Entities***. Although the TCJA included many corporate provisions, two of the most discussed changes were as follows:

(1) ***Corporate Tax***. The TCJA lowered the corporate income tax to 21%, a significant change for corporate income taxes.

(2) ***Pass-Through Deduction***. The TCJA added Code Section 199A, which allows for a 20% deduction for certain pass-through entities.[9] The combination of the pass-through deduction and the lower corporate tax caused some clients to change the form of their business entity to take advantage of the new tax regime.

iii) ***Taxation of Estates and Trusts***. Trusts and estates are subject to quite unfavorable tax rates and a rather complex taxation scheme that resembles that of a pass-through entity in some regards. Trustees and advisers must carefully monitor the tax liability of estates and trusts and, when appropriate, seek to push taxable income out to the beneficiaries so that the income will be taxed at the beneficiary's rate, which is presumably lower than the rate that would otherwise apply if the income were taxed to the estate or trust. Although fiduciary income tax is not within the scope of this manuscript, the updated tax information for estate and trusts for 2023 is included below for easy reference for advisers tasked with the administration of estates and trusts.

(1) ***Income Tax Rates***. Estates and trusts are subject to an incredibly condensed tax bracket that results in the taxation of

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[7] Treas. Reg. § 1.170A-1(h)(3) requires a taxpayer to reduce the value of a contribution to charity that results in a local tax credit or deduction, the value of the charitable contribution must be reduced by the amount of the credit or deduction (any such deduction or credit is a deemed quid pro quo benefit that negates the charitable deduction in the same manner as any return benefit received from a charitable entity).

[8] *See* I.R.S. Notice 2020-75, 2020-49 I.R.B. 1453.

[9] 26 U.S.C.A. § 199A (Westlaw through P.L. 116-258).

income at the highest rate with very modest income (significantly lower than the income required for a single individual or married individuals filing jointly). The 2023 income tax brackets for estates and trusts are as follows:[10]

Estates and Trusts	
Amount of Income	**Tax Rate**
Not over $2,900	10%
Over $2,900 but not over $10,550	24%
Over $10,550 but not over $14,450	35%
Over $14,450	37%

(2) ***Capital Gains Rates***. The capital gains tax rates for estates and trusts for 2023 are as follows:[11]

Estates and Trusts	
Amount of Income	**Tax Rate**
Not over $3,000	0%
Over $3,000 but not over $14,650	15%
Over $14,650	20%

(3) ***Effect of Suspension of Miscellaneous Deductions***. The TCJA suspended miscellaneous itemized deductions (e.g., those subject to the 2% floor) for individuals for tax years beginning January 1, 2018, through December 31, 2025.[12] It was unclear whether this suspension applied to estates and trusts and whether a beneficiary could benefit from the distribution of excess deductions in the year of termination of an estate or trust. The IRS issued final regulations effective October 19, 2020, that address these issues, as briefly discussed below.[13]

(a) ***Code Section 67(g) does not apply to Estates and Trusts***. Treasury Regulation Section 1.67-4(a) was revised to provide that an estate or trust must compute its adjusted gross income in the same manner as an individual, except that the following Code Section 67(e) deductions are allowed in the calculation: (i) costs paid or incurred in connection with the administration of the estate or trust that would not have been incurred had the property not been held in an estate or trust; (ii) deductions allowed under Code Sections 642(b) (personal exemption), 651 and 661 (distributions). Further, a provision was added to provide

[10] Rev. Proc. 2022-38, 2022-45 I.R.B. 445.
[11] *Id*.
[12] 26 U.S.C.A. § 67(g) (Westlaw through P.L. 116-258).
[13] Final Treas. Reg. §§ 1.67-4(d), 1.642(h)-2(f) and 1.642(h)-5(c), 85 F.R. 66219 (Oct. 19, 2020).

that Code Section 67(e) deductions are not itemized deductions and are not miscellaneous itemized deductions under 67(e) and are therefore not suspended by Code Section 67(g).

(b) ***Excess Deductions Benefit Beneficiaries***. Code Section 642 provides that in the year of termination of an estate or trust, if there are certain excess deductions that exceed the taxable income of the estate or trust, then those excess deductions will pass to the beneficiary or beneficiaries who can in turn claim those deductions on their individual tax returns for the year in which the estate or trust terminated. The suspension of miscellaneous itemized deductions under Code Section 67(g) called into question whether beneficiaries may still receive a benefit from the excess deductions. Treasury Regulations Section 1.642(h)-2 was revised to provide as follows:[14]

(i) Excess deductions will pass to the beneficiary succeeding to the property of the estate or trust.

(ii) The character of the excess deduction retains its character in the hands of the beneficiary as it was in the hands of the estate or trust. Specifically, those deductions may be characterized as a deduction allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction or as a miscellaneous itemized deduction (which is suspended for an individual under Code Section 67(g) until the tax year beginning January 1, 2026). Prior law treated these deductions as one single miscellaneous itemized deduction, which remains suspended until the tax year beginning January 1, 2026.

b) ***Transfer Taxes***. In addition to being concerned about income taxes, the ultra-wealthy are concerned with the transfer taxes under the Code—the estate tax, the gift tax and the generation-skipping tax. Each of these taxes is briefly discussed below.

i) ***Estate and Gift Tax***. The estate tax is levied on the estates of citizens of the United States, the estates of non-citizens who are residents of the United States and on United States assets owned by non-citizens who are residents of the United States. The estate tax is part of a unified transfer

[14] Treas. Reg. § 1.642(h)-2.

tax system that combines the estate and gift tax to tax both transfers during lifetime and at death (subject to certain deductions and credits). A full description of the unified estate and gift tax is beyond the scope of this manuscript. An update on the current basic exclusion amount that can be utilized for lifetime gifting or at death, the applicable tax rates and the gift tax annual exclusion are included below.

(1) ***Tax Rate***. The current maximum estate and gift tax rate is 40%.[15] This rate has fluctuated over the decades and was as high as 55% as recently as 2001.[16]

(2) ***Basic Exclusion Amount***. The basic exclusion amount is used to determine the applicable estate tax credit at death. Put simply, the basic exclusion amount is the value of assets that an individual may transfer during lifetime or at death without triggering gift or estate taxes. The basic exclusion amount has increased significantly throughout the past twenty-four years and, most recently, was doubled by the TCJA. The basic exclusion amount for 2023 is $12,920,000.[17] With portability, the total basic exclusion amount available to a married couple is $25,840,000. Note that the basic exclusion amount is scheduled to be reduced back to $5,000,000, as adjusted for inflation, according to the terms of the TCJA. A chart of the historical basic exclusion amount is included below.[18]

Year(s)	**Basic Exclusion Amount**
1997	$600,000
1998	$625,000
1999	$650,000
2000 – 2001	$675,000
2002 – 2003	$1,000,000
2004 – 2005	$1,500,000
2006 – 2008	$2,000,000
2009	$3,500,000
2010	$5,000,000 or $0
2011	$5,000,000
2012	$5,120,000
2013	$5,250,000
2014	$5,340,000
2015	$5,430,000

[15] 26 U.S.C.A. § 2001 (Westlaw through P.L. 116-258) and 26 U.S.C.A. § 2502 (Westlaw through P.L. 116-258).
[16] A Historical Look at Estate and Gift Tax Rates, 1 https://www.cch.com/press/news/historicalestategifttaxrates.pdf
[17] Rev. Proc. 2022-38, 2022-45 I.R.B. 445.
[18] Rocky Mengle, Estate Tax Exemption Amount Goes Up for 2021, https://www.kiplinger.com/taxes/601639/estate-tax-exemption (last visited Jan. 12. 2021). Subsequently updated by authors.

2016	$5,450,000
2017	$5,490,000
2018	$11,180,000
2019	$11,400,000
2020	$11,580,000
2021	$11,700,000
2022	$12,060,000
2023	$12,920,000

(3) ***Gift tax annual exclusion amount***. Code Section 2503(b) provides that the first $10,000 in gifts to an individual shall be excluded from the determination of a donor's taxable gifts in a tax year (the "annual exclusion amount"). The annual exclusion amount is indexed for inflation.[19] The annual exclusion amount for 2023 is $17,000 per individual.[20] The annual exclusion amount will enable a married couple to gift a total of $34,000 to each donee without triggering a taxable gift that reduces each individual's lifetime gift tax exemption or requires the payment of gift tax.[21] Utilizing the annual exclusion amount in an annual gifting strategy can be very beneficial to wealthy clients attempting to reduce their taxable estates. Developing the habit of making annual exclusion gifts to descendants or other family members can transfer significant wealth over time, particularly when utilizing the split-gift election for a married couple. In addition, annual exclusion gifts remove the value of the gift and appreciation attributable to the gifted property from the donor's estate.

ii) ***Generation-Skipping Transfer Tax***. The generation-skipping transfer tax is imposed by Code Section 2601 on generation-skipping transfers. Although an analysis of the generation-skipping transfer tax can be complex, in its basic form, a generation-skipping transfer is a transfer from a donor to an individual occupying the generation of a donor's grandchild (a different calculation exists for unrelated individuals). The generation-skipping transfer tax is imposed at a flat rate of 40%.[22] Each individual has a generation-skipping exemption amount that is equal to the basic exclusion amount utilized for estate and gift tax purposes.[23] Therefore, an individual's generation-skipping transfer tax exemption is $12,920,000 in 2023.

[19] 26 U.S.C.A. § 2503(b)(2) (Westlaw through P.L. 116-258).
[20] Rev. Proc. 2022-38, 2022-45 I.R.B. 445.
[21] Note, however, that a split-gift election of this nature requires the filing of a gift tax return for the year of the gift.
[22] 26 U.S.C.A. § 2641(a)(1) (Westlaw through P.L. 116-258) (providing that the applicable rate is calculated using the maximum federal estate tax rate).
[23] 26 U.S.C.A. § 2631(c) (Westlaw through P.L. 116-258).

c) ***Miscellaneous***.

i) ***Inflation Adjustments***. One change in the TCJA that did not garner much attention in the mainstream media but that has a significant impact on long term tax policy is the new method for calculating inflation adjustments. Specifically, the TCJA provided that inflation adjustments must now utilize the chained-CPI approach. The chained-CPI approach requires an inflation calculation that factors in a substitution effect in pricing goods. In the traditional calculation, the hypothetical basket of goods used to calculate inflation utilizes the same goods year over year—if the price of the specific goods increases, then there is inflation. Under the chained-CPI approach, if a good in a particular category becomes too expensive, it is assumed that consumers will substitute a cheaper good in the same category rather than continuing to purchase the exact same good at the higher price. Although this is perhaps a better method to analyze the spending habits of consumers, the chained-CPI approach will result in lower inflation rates and, more specifically, lower adjustments to income tax brackets, the basic exclusion amount, the annual exclusion amount and other tax items that are annually adjusted for inflation.

ii) ***Applicable Federal Rate***. The applicable federal rates ("AFRs"), which is often utilized in intra-family loans to avoid adverse income tax and gift tax issues, are at historical lows. As discussed below, this presents an opportunity for clients to provide significant benefits to family members without making a lifetime gift and can be quite helpful in certain transactions with trusts. The AFRs for February 2023 are as follows: the short-term AFR is 4.47%; the mid-term AFR is 3.82%; and the long-term AFR is 3.86%.[24]

iii) ***Code Section 7520 Rate***. The Code Section 7520 rate is utilized in calculating a remainder or reversionary interest—most often in determining the value of gifts in funding certain types of trusts. Like the AFR, the Code Section 7520 Rate is at a historic low, which presents a great opportunity for clients who are seeking to enter into lifetime transactions. The Code Section 7520 Rate for February 2023 is 4.6%.[25]

2) FY2023 Greenbook - Selected Provisions

a) Increase the corporate income tax rate from 21% to 28%

b) Increase top marginal income tax rate from 37% to 39.6% for taxable income over $450,000 for joint returns, $400,000 for single returns, $425,00 for head of household, and $225,000 for married filing separate.

[24] Rev. Rul. 2023-3, 2023-6 I.R.B. --.
[25] *Id*.

c) Tax capital gain and qualified dividends as ordinary income for taxpayers with taxable income over $1 million ($500,00 for married filing separately). Note that this is a change from adjusted gross income in the FY2022 proposal which would have applied to adjusted gross income (rather than taxable income) over $1 million.

d) Restrictions on GRATS, including (1) a 10-year minimum tern, (2) maximum of life expectancy of the annuitant public 10 years; (3) remainder equal to at least the great of 25% of the amount contributed to the GRAT or $500,000; a prohibition on any decrease in the annuity during the GRAT term; and a provision on the grantor acquiring an asset from the GRAT in an exchange without recognizing gain or loss on the exchange.

e) Deemed realization of capital gains by gift or at death. - Proposal would take effect 1/1/23 but would apply to pre-2023 appreciation. Gain would be recognized on transfer by gift or at death over the donor's or decedent's basis. The proposal contains an exception for tangible personal property such as household furnishings and personal effects, but not collectibles. The proposal would also exclude transfers to a spouse and transfer to charity. The Greenbook proposed a unified exclusion of capital gains for transfers during life and at death of $5 million (increased from the $1 million proposed last year), indexed for inflation

f) Payment of income tax by deemed owner treated as a gift unless the deemed owner is reimbursed by the trust during the same year in which the tax is paid.

g) Increase the limit on the reduction in value of special use property from $750,000 to $11.7 million

h) Limited duration for GST exemption to apply only to:

- Direct skips and taxable distributions to beneficiaries no more than two generation below the transferor and to younger generation beneficiaries who were alive at the creation of the trust; and
- Taxable terminations occurring while any person described above is a beneficiary of the trust.

i) Not included in 2023 Greenbook:

- Reduction of estate and gift tax exclusion prior to 2026
- Including grantor trust assets in the grantor's gross estate

3) IRS Priority Guidance Plan – Gifts and Estates and Trusts

a) Final regulations under §§1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent.

- Proposed and temporary regulations were published on March 4, 2016.

b) Guidance regarding availability of §1014 basis adjustment at the death of the owner of a grantor trust described in §671 when the trust assets are not included in the owner's gross estate for estate tax purposes

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

d) Guidance on portability regulatory elections under §2010(c)(5)(A).
   - PUBLISHED 07/25/22 in IRB 2022-30 as REV. PROC. 2022-32 (RELEASED on 07/08/22).

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

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

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

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

i) Final regulations under §2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.
   - Proposed regulations were published on April 17, 2008.

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

k) Regulations under §7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.
   - Proposed regulations were published on May 5, 2022.

4) §2053 Regulations

Under I.R.C. §2053(a), certain estate administration expenses may be deducted from the value of the gross estate. These expenses are: (1) funeral expenses; (2) administration expenses; (3) claims against the estate; and (4) unpaid mortgages on, or any indebtedness in respect, of property where the value to the decedent's interest in included in the gross estate.

Most recently final regulations under §2053 were issued in 2009. Those regulations generally limit the deduction for claims and expenses to those that are actually paid in settlement or satisfaction of the debt, with exceptions for certain items that are unpaid or unascertainable. The 2009 Regulations reserved §20.2053-1(d)(d)(6) to provide guidance on the appropriate application of present-value principles in determining the amount deductible. The 2022 Proposed Regulations were issued to provide that guidance.

a) ***Application of Present Value Principles***.

First, the Proposed Regulations propose to require the application of present-value discounting principles to amounts paid or to be paid after the third anniversary of the decedent's death. The Regulations state that:

> applying present-value principles to determine the allowable deduction under Section 2053 for payments made or to be made after an extended period following a decedent's death is consistent with the principals underlying section 2053 and the approach of the 2009 Regulations. By limiting the deduction to the discounted amount of a payment or payments made or to be made after an extended period following the decedent's death, the gross estate is reduced by a more accurate measure of the amounts not passing to the heirs and legatees.

The Regulations call this three-year period the "grace period." The discount rate for calculating the present value is the applicable Federal rate under Section 1274(d) for the month in which the decedent died, compounded annually. The length of time from the decedent's death to the date of payment (or expected payment) will determine whether the rate applicable is the Federal mid-term or long-term rate.

b) ***Deductibility of Interest as an Administrative Expense***.

The Proposed Regulations note that in order to be deductible, the interest expense must be actually and necessarily incurred in the administration of the decedent's estate and not constitute a transfer that is essentially donative in nature. The Proposed Regulations then provide a non-inclusive list of 11 factors that may support a finding that these requirements are satisfied. These factors are:

i) The interest rate on and the terms of the underlying loan (whether between related or unrelated parties), including any prepayment penalty, are reasonable given all the facts and circumstances and comparable to an arms-length loan transaction;

ii) The underlying loan is entered into by an executor of the decedent's estate acting in the capacity of executor or, if no executor is appointed and acting, the person accountable for satisfying the liabilities of the estate;

iii) The lender properly includes amounts of paid and/or accrued interest (including original issue discount as determined under sections 1271 through 1275 and the regulations in this part under those sections, such as original issue discount attributable to stated interest that is treated as part of the stated redemption price at maturity because it is not payable at least annually) in gross income for Federal income tax purposes, particularly if the lender is a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or trust (as defined in § 20.2053-1(b)(2)(iii));

iv) The loan proceeds are used to satisfy estate liabilities that are essential to the proper settlement of the estate, including, but not limited to, the Federal estate tax liability;

v) The loan term and payment schedule correspond to the estate's anticipated ability to make the payments under, and to satisfy, the loan, and the loan term does not extend beyond what is reasonably necessary;

vi) The only practical alternatives to the loan are the sale of estate assets at prices that are significantly below-market, the forced liquidation of an entity that conducts an active trade or business, or some similar financially undesirable course of action;

vii) The underlying loan is entered into when the estate's liquid assets are insufficient to satisfy estate liabilities, the estate does not have control (within the meaning of section 2701(b)(2)) of an entity that has liquid assets sufficient to satisfy estate liabilities, the estate has no power to direct or compel an entity in which it has an interest to sell liquid assets to enable the estate to satisfy its liabilities, and the estate's assets are expected to generate sufficient cash flow or liquidity to make the payments required under the loan;

viii) The estate's illiquidity does not occur after the decedent's death as a result of the decedent's testamentary estate plan to create illiquidity; similarly, the illiquidity does not occur post-death as a deliberate result of the action or inaction of the executor who then had both knowledge or reason to know of the estate tax liability and a reasonable alternative to that action or inaction that could have avoided or mitigated the illiquidity;

ix) The lender is not a beneficiary of a substantial portion of the value of the estate, and is not an entity over which such a beneficiary has control (within the meaning of section 2701(b)(2)) or the right to compel or direct the making of the loan;

x) The lender or lenders are not beneficiaries of the estate whose individual share of liability under the loan is substantially similar to his or her share of the estate; and

xi) The decedent's estate has no right of recovery of estate tax against, or of contribution from, the person loaning the funds.[26]

c) ***Substantiation Requirements for Valuation***.

Section 20.2053-4(b) and (c) provides exceptions to the general rule that in order to be deductible the expense must be actually paid. Section 20.2053-4(b) allows a deduction for claim and counterclaims in a related matter and 4(c) allows a deduction for the value of unpaid claims totaling less than $500,000.

The Regulations further provide that in order to be deductible, the value of the claims must be determined from a "qualified appraisal" by a "qualified appraiser" as described in the regulations under Section 170. The Proposed Regulations amend these requirements to dispose with the "qualified appraiser" and "qualified appraisal" requirements. The Proposed Regulations require that there be a written appraisal reflecting the current value of the claim. The valuation should take in to account post-death events, as well as those reasonably anticipated to occur. The proposal requires the appraisal to consider all relevant facts and elements of value that are known or that can reasonably be anticipated at the time of the appraisal. The appraisal must be prepared, signed under penalties of perjury and dated by a person who is not a family member of the decedent or the beneficiary or a related entity of the decedent or beneficiary. The appraisal must also include a statement describing the basis for the persons qualification to appraise the claim.

d) ***Deductibility Under Personal Guarantee***.

Finally, the Proposed Regulations address the deductibility of amounts paid pursuant to the decedent's personal guarantee. For payments made pursuant to a decedent's guarantee to be deductible, the claim must represent a personal obligation of the decedent existing at the time of the decedent's death, and the claim must be enforceable against the decedent's estate. However, not all enforceable debts are deductible under Section 2053.

A claim founded upon a decedent's guarantee is considered a claim founded upon a promise or agreement. Accordingly, the deduction for such a claim is limited to the extent that the guarantee was contracted "for an adequate and full consideration in money or money's worth." For a claim founded upon a decedent's guarantee to satisfy the "adequate and full consideration in money or money's worth" requirement and, therefore, be deductible under Section 2053, the decedent must have received a benefit reducible to money value in exchange for the decedent's guarantee.

The Proposed Regulations provide that a claim founded upon the decedent's agreement to personally guarantee a debt of another is a claim founded on a promise and, accordingly, must satisfy the applicable requirements in Section 2053(c)(1)(A) and § 20.2053-4(d)(5). Specifically,

[2626] Prop. Regs. §20.2053-3(d)(2)

the guarantee must have been bona fide and in exchange for adequate and full consideration in money or money's worth. The Proposed Regulations confirm that the bona fide nature of a claim related to the guarantee of a debt of a family member, a related entity, or a beneficiary will be determined with reference to § 20.2053-1(b)(2)(ii). The Proposed Regulations provide a bright line rule that a decedent's agreement to guarantee a bona fide debt of an entity in which the decedent had control (within the meaning of section 2701(b)(2)) at the time of the guarantee satisfies the requirement that the agreement be in exchange for adequate and full consideration in money or money's worth. Alternatively, the Proposed Regulations provide that this requirement also is satisfied if, at the time the guarantee is given, the maximum liability of the decedent under the guarantee did not exceed the fair market value of the decedent's interest in the entity. Finally, the Proposed Regulations provide that the estate's right of contribution or reimbursement will reduce the amount deductible in accordance with § 20.2053-1(d)(3).

e) ***ACTEC Comments***.

In response to the Treasury’s issuance of the Proposed Regulations, the American College of Trust and Estate Counsel (ACTEC) provided comments (the “Comments”). The Comments first address the proposed changes to the deductibility of interest expense on certain loan obligations.

The Proposed Regulations provide that interest expense is deductible only if, among other things, the loan is actually and necessarily incurred in the administration of the decedent’s estate and is essential to the proper settlement of the decedent’s estate. The Regulations go on to provide a nonexclusive list of factors to consider in determining whether interest expense payable pursuant to such a loan obligation of an estate satisfies the applicable requirements. Among those factors is (1) whether the loan obligation is entered into by the executor with a lender who is not a substantial beneficiary of the decedent’s estate (or an entity controlled by such a beneficiary) at a time when (2) there is no available alternative to obtain the necessary liquid funds to satisfy estate obligations and (3) without requiring a sale of illiquid assets at significantly less than their fair market value.

ACTEC notes that these proposals extend IRS scrutiny not only to actions taken after death that may create illiquidity, but also to legitimate estate planning during the decedent’s lifetime which produces illiquidity post-death. For example, planning that provides that subsequent generations don’t sell or otherwise dispose of inherited business interests or other assets that the decedent has spent a lifetime building. ACTEC recommended the following circumstances be expressly addressed by the Proposed Regulations:

i) The option of borrowing from a family-owned entity, including an operating business, may be not only most convenient but also most protective of the viability of that entity or business whose owners are faced with tax liabilities that shareholders of public corporations, for example, could satisfy simply by sales of stock that do not affect the company.

ii) Executor of estates are fiduciaries under state law and can be held liable by beneficiaries for wasting estate assets in a below-market sale to generate liquidity to pay estate taxes when loans (including from related parties) are available. This same consideration would apply to corporate executors such as banks or trust companies who would generally be unwilling to engage in such below-market sales due to these liability concerns. Therefore, an executor may make the decision to obtain a loan because estate assets could only be sold for a loss, but the IRS may not see the loan as necessary because the estate assets wouldn't have been sold for a "significant" loss. This puts executors in a Catch-22.

iii) The Proposed Regulations could also be construed to penalize estate planning that involves the use of life insurance policies on a decedent's life that are owned by and payable to irrevocable life insurance trusts ("ILITs"). An ILIT is commonly employed to create a source of liquidity outside of the decedent's taxable estate, with the trustee of the ILIT often lending the funds obtained through insurance proceeds to the executor to help fund the payment of estate taxes. ACTEC suggested that the Proposed Regulations be modified to expressly exclude such pre-death funding arrangements from causing an estate's interest deductions to be denied.

ACTEC then addressed the proposed changes to the appraisal requirements, noting that the qualified appraisal rules under Section 170 do not require the appraisal to be signed under penalty of perjury, and, in fact, no other provision in the Code or Regulations has this requirement. ACTEC recommended this requirement be deleted.

Finally, ACTEC addressed the proposals regarding amounts paid pursuant to a decedent's personal guarantee. ACTEC acknowledged that there must be consideration for a loan guarantee, but the courts have long held that the consideration need not be paid to the decedent. Rather, courts have held that a guarantor's obligation is contracted for adequate and full consideration in money or money's worth if there is a loan of money to a third party on account of a binding guarantee. The guarantor's right to subrogation constitutes adequate and full consideration if the guarantor had a bona fide expectation of repayment. No additional monetary consideration to the decedent is required for the loan guarantee.

5) Corporate Transparency Act

Congress enacted the Corporate Transparency Act ("CTA") at the beginning of 2021 as part of the National Defense Authorization Act. The CTA effectively implements a beneficial ownership registry and was passed to improve financial transparency and to combat the use of anonymous entities for illicit purposes such as money laundering, tax evasion and the financing of terrorism. The CTA requires certain business entities to report their "beneficial owners" and "company applicants" to the U.S. Treasury's Financial Crimes Enforcement Network ("FinCEN").

Proposed Regulations were issues on December 8, 2021 and Final Regulations were issued September 29, 2022.

The CTA requires "reporting companies" to disclose specific information regarding their "beneficial owners" and "company applicants" to FinCEN. The CTA defines a reporting company as:

> a corporation, limited liability company, or other similar entity that is— (i) created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe; or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian Tribe.[27]

Twenty-three types of entities are specifically excluded from the definition of reporting company, including large operating companies, (entities with a physical presence in the United States with over twenty full-time employees and which file federal tax returns reporting more than $5 million in gross receipts or sales), tax-exempt organizations, publicly traded companies, bank and bank-type entities, credit unions, insurance companies, and public accounting firms.[28] Private trusts are not formed by filing paperwork with the state and therefore are not specifically included in the definition of reporting company. In its comments ACTEC asked FinCEN to confirm that a private trust is not a reporting company, but Treasury declined to do so.

Another concern for advisors is in the definition of a beneficial owner. The CTA defines a "beneficial owner" as: an individual who, "directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, (i) exercises substantial control over the reporting company; or (ii) owns or controls at least 25 percent of the ownership interests of the reporting company."[29]

The Final Regulations provide three indicia for substantial control: (i) a senior officer of a reporting company indicates that an individual has substantial control; (ii) an individual with authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body); (iii) an individual with authority for direction, determination, or substantial influence over, important decisions of a reporting company will be deemed to have substantial control over the reporting company.[30]

The Final Regulations also identify ownership and control factors as pertaining to matters relating to estate planning and trusts. They provide that an individual may directly or indirectly own or control an ownership interest in a reporting company by virtue of "joint ownership with one or more other persons of an undivided interest in such ownership interest[,]" or "through another individual acting as a nominee, intermediary, custodian, or agent on behalf of such individual." As such, a person acting as an attorney in fact on behalf of another who has a 25% ownership interest in a reporting company is a beneficial owner who must be reported by the reporting company. [31]

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[27] Regs. §1010.380(c)(1)
[28] Regs. §1010.380(c)(2)
[29] Regs. §1010.380(d)
[30] Regs. §1010.380(d)(1)
[31] Regs. §1010.380(d)(2)(ii)

With respect to trusts or "similar arrangements" that hold an ownership interest in a reporting company, the following individuals are considered beneficial owners: (1) "a trustee of the trust or other individual (if any) with the authority to dispose of trust assets;" (2) "a beneficiary who: (i) is the sole permissible recipient of income and principal from the trust; or (ii) has the right to demand a distribution of or withdraw substantially all of the assets from the trust;" or (3) "a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust." [32]

The CTA defines a "company applicant" for purposes of the reporting requirements as an individual who directly files a document to create (with respect to a domestic reporting company) or first register (with respect to a foreign reporting company) a reporting company with a Secretary of State or similar office of a state, and also includes the individual who is primarily responsible for directing or controlling the individual to file the document. The Final Disclosure Regulations thus envision that a reporting company will have no more than two company applicants. One can easily envision lawyers and their staff (e.g., associate, paralegal, legal assistant), who regularly assist clients with the formation of entities, falling within the definition of "company applicant." [33]

The Final Regulations require that the reporting company disclose specific information about itself, its beneficial owners and its company applicant. For each reporting company, the reporting company must report the following:

a) Name (including d/b/a)
b) Business Address
c) Jurisdiction of formation
d) Unique identification [34]

For each beneficial owner and company applicant, the following information is required to be submitted to FinCEN:

a) Legal name
b) Date of birth
c) Residential address for beneficial owners
d) Business address for professional company applicants, and residential address for other company applicants
e) Unique identifying number from an acceptable identification document or FinCEN identifier
f) An image of the document from which the unique identifying number was obtained[35]

The CTA imposes a series of deadlines for submitting reports to FinCEN. Reporting companies in existence prior to January 1, 2024 must file their initial reports under the CTA by

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[32] *Id.*
[33] Regs. §1010.380(e)
[34] Regs. §1010.380(b)(i)
[35] Regs. §1010.380(b)(ii)

January 1, 2025.44 Reporting companies formed (for domestic) or registered (for foreign) on or after January 1, 2024, must file their initial reports within 30 days after formation or registration.45 If there is a change in beneficial ownership information, the entity will have to file an updated report within 30 days of the change.

6) Albrecht v. Commissioner, T.C. Memo 2022-53

The central question of this case was whether Martha Albrecht satisfied the contemporaneous written acknowledgement requirements of Section 170(f)(8)(B) to receive a charitable contribution deduction for her donation to the Wheelwright Museum of the American Indian (the "Museum").

Albrecht and her husband acquired a large collection of Native American jewelry and artifacts during their marriage. In 2014, Mrs. Albrecht donated 120 items from her collection (the "Donation") to the Museum. Pursuant to the express terms of a "Deed of Gift" (the "Deed"), Albrecht transferred "all rights, titles, and interests" in the property, unless otherwise stated in a separate "Gift Agreement". However, despite reference to a "Gift Agreement" no such agreement was attached to the Deed and the Museum did not provide Albrecht with any further written documentation concerning the Donation.

Albrecht filed Form 1040, U.S. Individual Income Tax Return, in which she reported the Donation on Schedule A, Itemized Deductions, and attached a copy of the Deed. The return was examined, and the IRS disallowed the Donation on the ground that the requirements of Code Section 170 were not met. Albrecht sought review in the Tax Court.

The Court noted that for any contribution of $250 or more, Section 170(f)(8)(B) requires that the taxpayer obtain from the donee organization, and maintain, a "contemporaneous written acknowledgement" (a "CWA"). The CWA must include (i) the amount of cash and a description (but not value) of any property other than cash contributed; (ii) whether the donee organization provided any goods or services in consideration, in whole or in part, for any such property; and (iii) a description and good faith estimate of the value of any such goods or services. The taxpayer must receive the CWA from the donee organization on or before the earlier of the date the taxpayer files his or her return or the due date for filing such return. The Court went on to note that a CWA is not required in any particular form, but the requirement that a CWA be obtained "is a strict one." A taxpayer may not deduct the contribution if the acknowledgment fails to meet the statutory and regulatory requirements.

The Tax Court found that the contemporaneous written acknowledgement requirements of Section 170(f)(8)(B) were not satisfied and thus no deduction was granted. The Deed failed to indicate, for example, that "no goods or services were provided by the Museum to Albrecht in exchange for the donation." Although the Deed stated that the donation was "unconditional and irrevocable" it also said that the donor transferred all rights "unless otherwise stated in the Gift Agreement." This separate agreement was not provided to Albrecht before she filed her tax return. The Court concluded that it appreciated "what appears to have been a good faith attempt by petitioner to substantially comply with the Code by executing the deed with the [Museum]" and that "substantial compliance, unfortunately for petition, does not satisfy the strict requirements of Section 170(f)(8)(B)."

7) Schweizer v. Commissioner, T.C. Memo 2022-102

Petitioner, Heinrich C. Schweizer, was born in Germany and received most of his education there, including his law degree. After passing the state law exam in Germany, Schweizer came to the United States to start an internship with Sotheby's in New York City. Eventually, he joined Sotheby's a permanent employee in the African art field.

Schweizer served a Director of African and oceanic Art at Sotheby's from 2006-2015. One aspect of his job was to evaluate African art held by customers and potential customer and give estimates of the price at which their art might sell at auction. He also worked directly with Sotheby's appraisal department, assisting its professionals in providing customers with formal appraisals concerning the fair market value of artwork.

Shortly after assuming his position at Sotheby's, Schweizer began donating works of African art to various museums. He claimed charitable contribution deductions for these gifts, all of which were reported on returns prepared by Schweizer's lawyer. These gifts included a work valued at $60,000 in 2007, a work valued at $100,000 in 2009, and a work valued at $5,000 in 2010. In 2011, the tax year at issue, petitioner decided to make a substantial contribution to the Minneapolis Institute of Art (MIA) of a Dogon sculpture that he had acquired in Paris, allegedly for $100,000, in 2003. (The Dogon people are indigenous to the central plateau region of Mali, in West Africa.)

On December 6, 2011, Schweizer donated the Dogon sculpture to the MIA. He received from an automatic six-month extension of time to file his 2011 return. On June 7, 2012, Schweizer's attorney requested a Statement of Value (SOV) from the IRS with respect to the Dogon sculpture. A taxpayer may request an SOV from the IRS Art Appraisal Services (AAS) unit before filing the return on which a gift of art is to be reported, hoping to receive assurance that the IRS will accept the value as claimed.

Schweizer's lawyer transmitted the SOV package to the AAS unit. This package included a one-and-a-half page "appraisal" of the Dogon sculpture by a New York dealer in African art, who valued the work at $600,000. The appraiser was not a certified appraiser and acknowledged that this was the only fair market value appraisal that he had ever done.

Schweizer did not receive a response from the AAS unit before his 2011 return became due. His attorney prepared, and petitioner filed a return claiming a $600,000 deduction for his gift of the Dogon sculpture. Schweizer included a partially completed Form 8283 with his return. When a taxpayer donates property (other than publicly traded securities) valued in excess of $5,000, Form 8283 instructs the taxpayer to include certain information on the form: The Form 8283 appended to Schweizer's 2011 return was missing most of the required information.

The IRS selected Schweizer's return for examination. During the examination an IRS staff appraiser determined that the FMV of the Dogon sculpture was $250,000. The IRS issued a notice of deficiency, asserting that no deduction was allowable because Schweizer failed to satisfy the statutory and regulatory substantiation requirements for this gift.

The court ruled on summary judgment that Schweizer had failed to satisfy these substantiation requirements because he did not attach to his 2011 return either a fully completed Form 8283 or an appraisal of any kind. Schweizer sought to avoid disallowance of his deduction by relying on the reasonable cause exception.

"Reasonable cause" requires a taxpayer to exercise ordinary business care and prudence. If a taxpayer alleges reliance on the advice of an accountant, return preparer, or other tax professional, the taxpayer must show that he "actually relied in good faith on the professional's advice." Schweizer argued that he received, and reasonably relied upon, advice from his attorney that Form 8283 was not required to be filed with his 2011 return. However, the Court found no factual support for that contention.

The Court went on to state that assuming that his attorneys told Schweizer that he didn't need to include either a fully completed Form 8283 or a qualified appraisal with his 2011 return, the Court found no credible evidence that petitioner actually relied on such advice in good faith. A taxpayer who advances a reliance-on-professional-advice defense must establish that his "reliance was reasonable."

Of particular relevance to the Court was that Schweizer was clearly familiar with Form 8283 and the section 170(f)(11) reporting requirements. He had made at least three prior tax-deductible contributions of African art. The Court held Schweizer knew that his 2011 return had to include a properly completed Form 8283, duly signed by the appraiser and an MIA officer, and that a qualified appraisal needed to be attached to the return.

8) Keefer v. United States, USDC ND TX, Case No. 3:20-cv-00836

In *Keefer v. United States*, the U.S. District Court for the Northern District of Texas addressed whether taxpayers were entitled to a charitable deduction for a contribution of a 4% limited partnership interest to a donor-advised fund.

Burbank HHG Hotel, LP ("Burbank") was a limited partnership that owned and operated a single hotel property (the "Hotel"). Kevin Keefer was a limited partner in Burbank. On April 23, 2015, Burbank and Apple Hospitality REIT ("Apple"), exchanged a nonbinding letter of intent (the "LOI") for a deal that included Apple's purchase of the Hotel. Burbank did not sign the LOI but continued negotiating for the Hotel's sale. On June 18, 2015, Kevin assigned a 4% limited partnership interest in Burbank to the Pi Foundation ("Pi") for the purpose of establishing a donor advised fund (the "DAF"). As of that date, Burbank had tentatively agreed to the sale of the Hotel to Apple for $54 million, but the contract for sale had not been signed and Apple had not conducted its review of the property and records. On July 2, 2015, Burbank and Apple signed a contract for Apple to purchase the Hotel for $54 million. The contract provided for a thirty-day review period for Apple to evaluate the property.

On June 5, 2015 (before the transfer of the limited partnership interest) Pi sent Kevin a packet of materials (the "DAF Packet") related to the "Keefer Donor Advised Fund." Part of the language of the packet referred to an "irrevocable gift" to Pi of the limited partnership interest.

On September 9, 2015, Pi sent an Acknowledgement Letter to Kevin, which read in full as follows:

> Thank you for your donation to The Pi Foundation, Inc. of a 4.00% interest in Burbank HHG Hotel, LP. The Pi Foundation, Inc., is a 501(c)(3) nonprofit organization. Your contribution is tax-deductible to the extent allowed by law. No goods for services were provided in exchange for your generous financial donation. Please keep this page for your records.

To substantiate the donation, the Keefers obtained an appraisal of the donated partnership interest as of June 18, 2015. The appraisal stated that its purpose was to estimate the value of a limited partnership interest "subject to an oral agreement." The referenced oral agreement was that the donee would only share in the net proceeds from the sale; it would not share in the assets of the partnership not covered in the sale.

The appraiser concluded the value of the donation was $1,257,000, and the Keefers accordingly took a charitable contribution deduction. The IRS examined the return and sought to disallow the deduction. In its Notice of Deficiency, the IRS stated in part

> It has not been established that the Taxpayers are entitled to deduct a charitable contribution in the amount of $1,257,000, [because] they did not have [a contemporaneous written acknowledgement ("CWA")] from the done organization showing that the donor advised fund "has exclusive legal control over the assets contributed" and their appraisal did not include the identifying number of the appraiser. Therefore, this deduction is not allowable.

The Keefers paid the additional tax and penalties and sought a refund. When the refund request was denied, they appealed.

On appeal, the Court looked at two separate issues: (1) whether the transfer was an anticipatory assignment of income; and (2) whether the charitable deduction was properly denied. In addressing the first issue, the Court noted that the "assignment of income doctrine holds that one who earns income cannot escape tax upon the income by assigning it to another." The court further noted that a court will respect a donation of appreciated stock if the donor "(1) gives the property away absolutely and parts with title thereto (2) before the property gives rise to income by way of a sale."

The Court first addressed the second prong of the above test and held that Burbank's right to the income from the sale of the hotel had not vested in the Keefers when they assigned the interest to Pi. The Court found that there was not binding obligation at the time of the donation; the hotel was not even under contract.

The Court then turned to the first prong – whether the Keefers gave away the entire interest, or whether in assigning the interest, subject to an oral agreement, they carved out a portion of the interest. If that was the case, they retained a partial interest in the asset after the assignment and the anticipatory assignment of income would apply.

Kevin Keefer testified that the oral agreement was an agreement among the pre-assignment partners to pay to them the amount that had previously been held as reserves. As such, Pi did not have the right that the other partners had to share in the available cash flow of the partnership, only the share of the net proceeds. Therefore, the Court held that the Keefers did not transfer the full partnership interest.

The Court then turned to whether the IRS correctly denied the charitable contribution deduction because they did not obtain a CWA. The Keefers argued that together the DAF Packet and the Acknowledgement Letter, together, constituted a CWA. The Court disagreed holding the Packet could not be a written acknowledgement, because an acknowledgement memorializes a completed gift. The Packet was delivered to Keefer <u>before</u> the donation was made. The Court also ruled that the Acknowledgement Letter could not supplement the Packet, thereby making it a CWA, because the Letter did not reference or incorporate the terms of the packet. Specifically, the Acknowledgment Letter did not reference the Keefer DAF at all, or even state that Pi was a provider of DAFs. Therefore, the text of the Acknowledgment Letter did not provide the Court any basis on which to incorporate the DAF Packet's provisions.

9) Estate of Levine v. Commissioner, 158 T.C. No. 2 (Feb. 28, 2022)

Marion Levine and her husband George Levine, who died in 1974, opened a supermarket in 1950, which grew into a 27-store multi-million-dollar company. After her husband died, Marion sold the supermarket business for $5 million; however, instead of retiring quietly, Marion used the proceeds to embark on new business ventures and eventually increased her net worth to $25 million over the next 20 years. These new businesses consisted of real estate ventures, several mobile-home parks, a stock portfolio she had started in the early 1960 and tended herself, two Renaissance fairs (in Arizona and North Carolina).

In the late 1990's Marion began to focus on her estate planning. She had two children, who she named as her agents under a Durable General Power of Attorney. However, because her children did not always get along, Marion named a close family brined and business associate, Bob Larson, as a third agent. Marion also named her children and Larson as successor co-Trustees under her Revocable Trust Agreement (the "Revocable Trust").

As part of her broader planning, Marion decided to use intergenerational split-dollar life insurance as part of her estate plan. In 2008, she created an irrevocable trust (the "Insurance Trust") to own the life insurance. An independent trust company served as trustee and Marion's children and grandchildren were the beneficiaries. Under the terms of the Insurance Trust, the independent trustee was a directed trustee and an "investment committee" had the power to direct investments. The "investment committee" consisted of Larson, alone.

The Insurance Trust agreed to buy insurance on the lives of Marion's daughter and son-in-law (apparently her son was uninsurable) and the Revocable Trust agreed to pay the premiums on the policies. In return, the Insurance Trust agreed to assign the policies to the Revocable Trust as collateral and agreed to pay to the Revocable Trust the greater of (i) the total amount of the premiums paid ($6.5 million); and (ii) either (a) the current cash-surrender values of the policies upon the death of the survivor of Marion's children, or (b) the case- surrender values of the policies on the date they were terminated, if terminated before the insureds died. The Insurance Trust, alone, had the right to terminate the policies.

When Mrs. Levine died, her estate valued the split-dollar receivable at about $2 million. The IRS disagreed on this valuation, assessed an additional $3 million in taxes and a 40% gross mis-valuation penalty. The IRS's arguments were based on I.R.C. sections 2036, 2038 and 2073.

Section 2036 provides that the date of death value of transferred property is included in a decedent's estate if the decent either (1) retained the right to the use or enjoyment of the property or the income therefrom; or (2) retained the right – either alone or in conjunction with another person – to designation who could use and enjoy the property or the income therefrom. The IRS argued that Mrs. Levine retained the right to the income, or the right to designate who enjoyed the income, under the split-dollar arrangement.

Section 2038 brings the date of death value of transferred property back into a decedent's estate if the decedent retains the right – either alone or in conjunction with another person – to alter, amend, revoke, or terminate the transfer. The IRS argued the Marion retained the right to alter, amend, revoke, or terminate the split-dollar arrangement.

Section 2073 provides that under certain circumstances, property must be valued for transfer tax purposes without regard to any restriction on the use of the property that would result in a lower value. The IRS argued that any restrictions in the split-dollar arrangement should be disregarded under §2073 and therefore the full cash-surrender value of the policies should be included in Mrs. Levine's estate.

Judge Holmes determined that section 2036(a)(1) did not apply because Marion did not retain the right to any benefit under the split-dollar arrangement – she could not surrender the policies or terminate the split-dollar arrangement. It was trued that Larson had the power to terminate the arrangement, and he was also a co-agent under Marion's power of attorney; however, he could not terminate the arrangement and surrender the polices as attorney-in-fact on Marion's behalf because Marion had no power to do that herself. Therefore, the Court held that Marion did "not retain any right to possession or enjoyment of the property transferred." The Court made a point to draw a distinction between the case at hand and the *Morrissette II* and *Cahill* cases in which the donor and the trust could mutually agree to terminate the arrangement.

IRS also tried to argue that §2036(a)(2) applied because Marion had the right to determine who could enjoy the transferred property because under basic contract principles, she and the Insurance Trust could agree to alter the split-dollar arrangement. The Court held that rights to modify contracts under general default rules of contract are not rights held "either alone or in conjunction with any other person" under section 2036(a)(2).

The IRS also argued that Marion, through her agent, Bob Larson, "stood on both sides of these transactions and therefore could unwind the split-dollar transactions at will." The IRS sought to have the reasoning in *Strangi,* and *Powell* apply to bring the full cash surrender value of the policy back into the estate.

In *Strangi*, the decedent had the right (along with others) to dissolve a family limited partnership to which he had transferred property. He also retained the right, through his son-in-law, to determine the amount and timing of partnership distributions. The court in that case noted that any potential fiduciary duties with respect to the exercise of these rights were essentially owed to the decedent himself because the decedent could act with others to dissolve a partnership and, through his son-in-law who was his agent under a power of attorney and general partner, could determine the amount and timing of distributions.

Similarly, in *Powell*, a fiduciary owed duties to the decedent both as this agent and partner in a family limited partnership. The court there found that there was nothing to suggest that as a fiduciary he "would have exercised this responsibility as a general partner of [the family limited partnership] in ways that would have prejudiced decedent's interests.

In contrast to *Strangi* and *Powell*, Larson's power to terminate did not, in effect, give Marion rights over the cash surrender values because he also had conflicting fiduciary duties to other beneficiaries. He owed fiduciary duties to Marion's grandchildren, who were beneficiaries of the life insurance trust in addition to decedent's children, and those grandchildren would have received nothing if he had terminated the arrangement early.

The Court held that the same reasons as set forth above prevented section 2038 from applying.

In its final argument, the IRS argued that when Marion entered into the split-dollar arrangement, she placed restrictions on her ability to control the $6.5 million cash gift and insurance policies, and that these restrictions should be disregarded under §2703 when determining the value of the life insurance policies. The Court dismissed this argument nothing that the "property" referred to in §2703 is "property of an estate, not some other entity's property." Therefore, "property" could not refer to the life insurance policies that were owned by the Insurance Trust and were never owned by Levine. The Court held that restrictions in the split-dollar arrangement had nothing to do with what was owned by the estate (which was the receivable under the agreement) but only to the surrender of the policies (which were owned by the Insurance Trust).

10) Estate of DeMuth v. Commissioner, T.C. Memo 2022-72

In Estate of DeMuth v. Commissioner, the Tax Court addressed whether the value of ten checks written before, but paid after, Decedent's death were properly includible in Decedent's gross estate.

William E. Demuth, Jr. ("Decedent") was domiciled in Pennsylvania and died testate on September 11, 2015. Donald Demuth, Decedent's son ("Donald"), was appointed executor of Decedent's estate. Prior to his death, Decedent executed a power of attorney and appointed Donald as his agent. Donald was authorized to give gifts from Decedent's financial assets to the Decedent's issue in amounts not exceeding the annual gift exclusion. One of Decedent's financial assets was an investment account at Mighty Oak Strong America Investment Co. ("Mighty Oak"). The Mighty Oak account included the authority to write checks on the account.

Five days before Decedent's death, Donald wrote eleven checks, totaling $464,000, from Decedent's Mighty Oak account. One check was paid before Decedent's passing. Three checks were deposited by the payees on September 11, 2015, but paid by Mighty Oak on September 14, 2015. The remaining seven checks were paid by Mighty Oak on or after September 15, 2015.

On Schedule B of Decedent's estate tax return (Form 706), Donald reported the value of the Mighty Oak account as $442,639—a value that excluded all eleven checks written on September 6, 2015. The return was selected for audit. On July 18, 2019, the Internal Revenue Service issued a notice of deficiency, determining that the Mighty Oak account was undervalued by $436,000—the value of the ten checks paid after Decedent's death. Donald timely petitioned the Tax Court on behalf of the estate and submitted the case for decision without trial.

The Tax Court noted that Treas. Reg. §25.2511-2(b) provides that "a gift is not considered complete until a donor has parted with dominion and control as to leave him with no power to change its disposition." The Court went on to note that it must examine relevant state law to determine when a decedent parts with control of the funds in their account after they draw a check.

According to Pennsylvania law, in order to make a valid inter vivos gift, there must be a clear, satisfactory, and unmistakable intention of the giver to part with and surrender dominion over the subject of the gift, with an intention to invest the donee with the right of disposition beyond recall, accompanied by an irrevocable delivery, actual or constructive. The Pennsylvania Commercial Code provides that the first possible time at which a gift of a check may be deemed complete is when the drawee bank accepts, certifies, or makes final payment of the check. In context, acceptance means the drawee's signed agreement to pay a draft as presented. Accordingly, because the checks were not paid by Mighty Oak until after Decedent's death, those checks were includable in Decedent's gross estate. However, the analysis did not stop there.

Interestingly, the IRS mistakenly conceded the issue as to three checks in its Joint Stipulation of Facts (the "Stipulation"). The Stipulation incorrectly stated that three checks were "deposited and credited to the accounts of the following payees by their respective *drawee banks*." In reality, the payees had deposited the checks in their banks, the *depository banks*; no draw had been made on the drawee bank. The IRS tried to withdraw this concession, but the Court rejected the withdrawal finding that it would put the taxpayer at a disadvantage.

11) CCM 202152018.

CCM 202152018 addressed whether the fair market value of stock should take into consideration the likelihood of a merger as of the date of the transfer of the shares to a Grantor Retained Annuity Trust ("GRAT").

Donor transferred shares in Company to a two-year GRAT under which the trustee was to base the amount of the annuity payment on a fixed percentage of the initial fair market value of the trust property. In determining the initial fair market value, Donor used an appraisal dated seven months prior to the transfer, which Donor obtained to satisfy the reporting requirements for nonqualified deferred compensation plans.

Between the appraisal date and the date of transfer, Donor began merger discussions and obtained four offers to sell a minority interest in Company. Six months after the transfer to the GRAT, Company accepted an offer three times greater than the value that was used to determine the annuity amount for the GRAT. A subsequent year end appraisal was completed, but the original appraisal was used to value the shares.

The IRS concluded that Donor did not retain a qualified annuity interest. The IRS reasoned that under the fair market value standard, the hypothetical willing buyer and willing seller would be reasonably informed during the course of negotiations over the purchase and sale of the shares and would have knowledge of all relevant facts, including the pending merger. The Service held that to ignore the facts and circumstances of the pending merger undermined the basic tenets of fair market value and yielded a baseless valuation. Additionally, even though the GRAT agreement appeared to meet the requirements of §2702, the IRS concluded that "intentionally basing the fixed amount required by § 2702(b)(1) and § 25.2702-3(b)(1)(i) on an undervalued appraisal causes the retained interest to fail to function exclusively as a qualified interest from the creation of the trust."

12) Baty v. Commissioner – US Tax Court (Settled)

Daniel Baty was the co-founder of Emeritus Senior Care ("Emeritus"), which operated assisted living communities. Over two decades Emeritus evolved from regional company to one publicly traded on the New York Stock Exchange with almost $2 billion in annual revenue.

During 2013, Emeritus began entertaining offers from several strategic partners. By the end of the year, Emeritus narrowed down the offers to two and asked for the "best and final" offers. Eventually, Emeritus decided to negotiate with Brookdale Senior Living ("Brookdale"). Brookdale had offered to exchange its shares for Emeritus shares on a 1:1 ratio. In January 2014, the Emeritus Board of Directors authorized management to negotiate exclusively with Brookdale.

Also in January, Baty established a grantor-retained annuity trust (the "GRAT"). It was a two-year, zeroed out GRAT. Baty transferred Emeritus shares on January 14, 2014, and valued the shares based on the average of the high and low trading prices. Under SEC Rule 144, Baty, as Chairman of the Board of Emeritus, was subject to certain limitations on the trading or transfer of his stock because of the pending merger negotiations.

Twenty-one days after Baty transferred the shares, Brookdale insisted on an unfavorable change in the stock exchange ratio. Ultimately, the deal was finalized (with the unfavorable changes) on February 17, 2014 and announced publicly on February 20.

The IRS issued a Notice of Deficiency, asserting that the fair market value of the transferred shares was based on the post-merger value, not the publicly-traded value on the date of transfer. The IRS argued that the valuation should have considered the merger negotiations (even though those negotiations were not public at the time of the transfer to the GRAT). The IRS also refused to adjust the annuity payment based on the revaluation, even though the GRAT called for such adjustment.

Note that the IRS position places an undue burden on the donor, in that is presupposes that a willing buyer would be privy to information that the seller is legally bound to keep secret. In this case, Baty was restricted in the transfer he could make and could not disclose the merger discussions, yet the IRS sought to impute this knowledge to a "willing buyer".

Before responding to the Petitioner's Motion for Summary Judgment, the IRS conceded the issue. However, there is no guarantee the Service will back off of its position in CCM 202152018 (discussed above).

13) CCA 2021118008.

CCA 2021118008 addressed the tax effects of the commutation of a QTIP Trust resulting from an agreement among the Spouse and the remainder beneficiaries of the QTIP.

In CCA 2021118008, Decedent created a QTIP Trust for the benefit of Spouse. Spouse had a testamentary limited power of appointment among Decedent's descendants. Upon Spouse's death, the Trustee was directed to distribute unappointed trust assets to Decedent's two children by right of representation. Spouse and Decedent's children entered into an agreement by which the QTIP was commuted, and all of its assets were distributed outright to Spouse.

The IRS concluded that the commutation of the QTIP is a disposition of the surviving spouse's qualifying income interest within the meaning of § 2519(a), and thus, the surviving spouse is treated as making a gift of all of the interests in the QTIP other than the qualifying income interest.

In addition, the IRS concluded, the distribution of all of the QTIP property to the surviving spouse constitutes a transfer of the remainder interest and a gift by the remainder beneficiaries under § 2511. Further, the deemed gift by the surviving spouse under § 2519 and the gift by the remainder beneficiaries to the surviving spouse under § 2511 cannot be offset.

14) CCM 202233014

CCM 202233014 addressed whether an estate is entitled to an estate tax charitable deduction or estate tax marital deduction for a unitrust interest in a qualified charitable remainder unitrust, where the trustee had the discretion to pay the unitrust interest either to the Spouse or the Charity.

The Charitable Remainder Unitrust ("CRUT") required the trustee to distribute 25% of the unitrust amount (1.25% of the CRUT) to the donor's spouse and gave the trustee discretion to distribute the remaining 75% of the unitrust amount (3.75% of the CRUT) to either charity or spouse during spouse's lifetime. Upon spouse's death, the Trustee was obligated to distribute the remainder of the CRUT to charity. The IRS concluded that the value of the charitable remainder was deductible for estate tax purposes, and that the 1.25 percent unitrust interest payable to Spouse qualified for the estate tax marital deduction. However, it disallowed a deduction for the value of the 3.75 percent unitrust interest that could pass toe spouse or charity in Trustee's discretion. Neither the interest of the spouse nor the interest of the charity was ascertainable as of donor's death.

Note, this is a reverse of course for the IRS. The footnote to the Memorandum notes that:

> The analysis and conclusion would be the same under § 2523 for a completed gift transfer to a CRUT with similar terms. In PLR 200813006, PLR 200832017, PLR 201117005, and PLR 201845014, this office ruled that taxpayers were entitled to an estate tax marital deduction under § 2056 or a gift tax marital deduction under § 2523 for a unitrust interest in a CRUT that can be distributed between charity and spouse at the trustee's discretion. The position in these earlier rulings no longer reflects the position of this office.

15) CCA 202202011

In CCA 202202011, the Chief Counsel's Office address the time for when the statute of limitations for assessments related to a delinquent Form 706 begins to run. The fiduciary filed the estate tax return with the field office which then forwarded it to the Service Center. The Chief Counsel's Office determined that the statute of limitations begins running when the Form 706 has been received by the Service Center serving the location in which the decedent was domiciled at the time of his death.

16) PLR 202217005

PLR 202217005 addressed whether a seemingly broad testamentary power of appointment was a limited power of appointment or a general power of appointment and the impact of the power of appointment on the subject trust's pre-1985 GST trust status.

The settlor created a revocable trust and died before September 25, 1985. Upon the settlor's death, a trust for her son ("Son's Trust") was created. Son's Trust included a testamentary power of appointment in favor of the settlor's descendants. Settlor's son died and exercised his power of appointment by directing the property of Son's Trust to the Trustee of Son's Revocable Trust ("Trust 2"). Trust 2 provided that the property appointed to Trust 2 through the settlor's son's power of appointment was to be administered through a separate trust for the benefit of Granddaughter. Trust 2 granted the Granddaughter a testamentary power of appointment in favor of Granddaughter's descendants or the settlor's descendants, excluding (1) settlor's children and (2) settlor's grandchildren who did not have descendants.

The Trustees filed a petition in state court to determine the construction of the power in Trust 2. The state court held that Trust 2:

> shall be construed so that the language of [Granddaughter's] Power of Appointment grants [Granddaughter] a limited power to appoint the property remaining in [New Trust] on her death only among [Settlor's] then-living descendants, or trusts for their benefit, other than to a child of [Settlor] and a grandchild of [Settlor] if such grandchild does not have at least one then living descendant.

In making its determination, the Service referenced *Commissioner v. Estate of Bosch*, in which the Supreme Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The *Bosch* court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Instead, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state.

With deference to the state court ruling, IRS ruled that Granddaughter's testamentary power of appointment did not include her estate or creditors of her estate and therefore was a limited power of appointment. As a result, the Granddaughter's trust remained GST tax exempt under its grandfathered status, no part of Granddaughter's trust would be included in Granddaughter's gross estate for federal estate tax purposes, and Granddaughter did not release a general power of appointment for federal gift tax purposes and did not make a constructive addition to the trust.

17) PLR 202206008

PLR 202206008 addressed the effect of the modification of a pre-1985 GST trust to grant the beneficiaries a general power of appointment over a "Defined Portion" of the assets of the GST trust on its GST-exempt status.

Grantor died prior to Sept. 25, 1985, and Grantor's Will created a Trust for the benefit of Grantor's child (referred to as "Trust B" in the PLR). Accordingly, the Trust was exempt from GST tax. The Trust required distributions of the net income to child during child's life and permitted discretionary distributions of principal "for the maintenance, education, welfare and comfort of any beneficiary or beneficiaries." Upon the child's death, the Trust terminated and the remaining assets were directed to be distributed to the child's surviving descendants, per stirpes, if any, or if none, to the Grantor's wife's heirs at law.

There was a dispute among the beneficiaries about the Trustee exercising his discretionary authority to give child a power of appointment. As a result of that disputed, the parties entered into a settlement agreement.

The settlement agreement modified the Trust to grant the child a testamentary general power of appointment to appoint a "Defined Portion" of the principal to child's estate. "Defined Portion" was defined as "the largest portion of [the Trust] that could be included in Child's federal estate without increasing the total amount of the transfer taxes actually payable at Child's death over and above the amount that would have been actually payable in the absence of this provision." Any assets not subject to this power, were directed to be distributed to child's surviving descendants, per stirpes, if any, or if none, to the Grantor's wife's heirs at law.

The IRS determined that the modification would not cause the Trust to lose its GST-exempt status. Under Code Section 1433(b)(2)(A) and Treasury Regulations Section 26.2601-1(b)(1)(i), the GST tax generally does not apply to transfers under a trust that was irrevocable on September 25, 1985. Treasury Regulations Section 26.2601-1(b)(4)(i)(D) provides that a valid modification of an exempt trust's governing instrument will not cause the trust to be subject to GST tax if the modification does not (i) "shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification," and does not (ii) "extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust." The IRS concluded that the modification would not shift a beneficial interest or extend the time for vesting of any beneficial interest, as described above, and therefore, the modification will not cause the Trust "to lose its exempt status from the GST tax or otherwise become subject to the GST tax."

The IRS also ruled that the modification would cause property subject to the child's testamentary general power of appointment to be included in the child's gross estate under Code Section 2041(a)(2).

18) Sorensen – US Tax Court (Settled)

Chris and Robin Sorensen grew up in a family of firefighters; their father was a captain at the local firehouse. Their parents also owned a local television store. Chris and Robin watched their parents run a small business, where they learned the value and importance of providing good customer service.

Chris and Robin eventually followed in their father's footsteps and became firefighters and EMTs. However, they also felt another calling – to open a restaurant. Eventually, they decided to open a sandwich business because they understood it was less expensive to start than other types of restaurants

In 1994, the brothers started Firehouse Subs, Inc. in Jacksonville, Florida with approximately $28,000 borrowed from family and friends. The restaurant started with one paid employee; the rest of the restaurant's staffing needs were covered by members of the Sorensen family, including (in addition to Robin and Chris) Robin and Chris's parents, wives, and sisters, and ultimately some of their children.

In 1995, the brothers formed Firehouse Restaurant Group, Inc. ("Firehouse"). Firehouse originally served as a franchisor, and also generally managed and licensed trademarks related to sub sandwiches under the name of "Firehouse Subs."

As their business continued to grow and become more profitable, the brothers decided to embark on more sophisticated estate planning. Each of them (as grantor and trustee) created a living trust in 2011 ("Robin's Living Trust" and "Chris's Living Trust). In 2014, each of them created irrevocable grantor trusts. Robin's wife, Tabitha was trustee of his irrevocable trust ("Robin's Family Trust") and Chris' wife, Kirsten, was trustee of his irrevocable trust (Chris' Family Trust").

Prior to the transfers at issue in this case, on December 28, 2014, the brothers owned Firehouse stock through their revocable trusts. Specifically, the shareholders of Firehouse stock were as follows:

Shareholder	**Shares**	**% Interest**
Robin's Living Trust	3,200	35.56%
Chris's Living Trust	3,200	35.56%
Other Shareholders	2,600	28.88%
Total	**9,000**	**100.00%**

In 2014, at the advice of their advisors, the brother decided to make gifts of Firehouse stock to their respective irrevocable trusts. However, the brothers wanted to maintain their collective voting control of the corporation. In order to address this, the Firehouse stock ownership was recapitalized, dividing the shares into voting stock and non-voting stock.

After recapitalization, the shareholders of Firehouse stock were as follows:

Shareholder	**Voting**	**Non-voting**	**Total**	**% Interest**
Robin's Living Trust	3,200	28,800	32,000	35.56%
Chris's Living Trust	3,200	28,800	32,000	35.56%
Other Shareholders	2,600	23,400	26,000	28.88%
Total	**9,000**	**81,000**	**90,000**	**100.00%**

After consulting with their estate planning attorney, the brothers decided to make defined value gifts of non-voting shares in the amount of $5,000,000 to their respective Family Trusts. On December 31, 2014, Robin, as trustee of Robin's Living Trust, made a gift of Firehouse non-voting shares worth $5,000,000 to Tabitha, as trustee of Robin's Family Trust, defined in the Irrevocable Stock Power transfer document as:

> [A] specific number of nonvoting shares in FIREHOUSE RESTAURANT GROUP, INC., a Florida corporation (the "Company"), that have a fair market value as finally determined for federal gift tax purposes equal to exactly $5,000,000. The precise number of shares transferred in accordance with the preceding sentence shall be determined based on all relevant information as of the date of transfer in accordance with a valuation report that will be prepared by the Dixon Hughes Goodman, LLP ("DHG"), Jacksonville, Florida, an independent third-party professional organization that is experienced in such matters and appropriately qualified to make such

> a determination. However, the determination of fair market value is subject to challenge by the Internal Revenue Service (“IRS”). While the parties intend to initially rely upon and be bound by the valuation report prepared by DHG, if the IRS challenges the valuation and a final determination of a different fair market value is made by the IRS or a court of law, the number shares transferred from the transferor to the transferee shall be adjusted accordingly so that the transferred shares have a value exactly equal to $5,000,000, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or court of law.

Also on December 31, 2014, Chris, as trustee of Chris's Living Trust, made a gift of Firehouse non-voting shares worth $5,000,000 to Kirsten as trustee Chris's Family Trust, defined in an identical Irrevocable Stock Power transfer document in the same manner.

Robin and Chris reported the gifts of stock on their 2014 gift tax returns. The gifts were reported as follows: “[A] number of non-voting shares of stock in Firehouse Restaurant Group, Inc. (“Firehouse”) that have a value as finally determined for federal gift tax purposes equal to $5,000,000 as of the date of the transfer.” The returns further stated:

> Based on the summary report on the valuation of one non-voting share in Firehouse Restaurant Group, Inc. as of December 31, 2014, attached and marked as Exhibit II (the 'Valuation Report'), the value of one non-voting share of Firehouse stock as of the date of the gift was determined to be $532.79. Therefore, based on the formula set forth above and the value as determined by the Valuation Report, the donor transferred 9,385 non-voting shares in Firehouse stock [. . .] with a value equal to $5,000,000, and the precise number of shares transferred cannot be finally determined until the value of such shares are finally determined for federal gift tax purposes.

After the gifts and completion of the appraisal, the shareholders of Firehouse stock were as follows:

Shareholder	**Voting**	**Non-voting**	**Total**	**% Interest**
Robin's Living Trust	3,200	19,415	22,615	25.13%
Robin's Family Trust	0	9,385	9,385	10.43%
Chris's Living Trust	3,200	19,415	22,615	25.13%
Chris's Family Trust	0	9,385	9,385	10.43%

Shareholder	Voting	Non-voting	Total	% Interest
Other Shareholders	2,600	23,400	26,000	28.88%
Total	**9,000**	**81,000**	**90,000**	**100.00%**

After using their available exemptions in 2014, the brothers decided to sell additional interests to their irrevocable trusts. In 2015, Robin and Chris each sold 5,365 Firehouse non-voting shares to the trustees of their respective Family Trusts. Because the sales occurred just 3 months after the prior gifts, the purchase price was based on the December 31, 2014 appraisal. Each of the irrevocable trusts satisfied the purchase price through promissory notes secured by stock pledge agreements.

After the 2015 sales to the Family Trusts, the shareholders of Firehouse stock were as follows:

Shareholder	Voting	Non-voting	Total	% Interest
Robin's Living Trust	3,200	14,050	17,250	19.17%
Robin's Family Trust	0	14,750	14,750	16.39%
Chris's Living Trust	3,200	14,050	17,250	19.17%
Chris's Family Trust	0	14,750	14,750	16.39%
Other Shareholders	2,600	23,400	26,000	28.88%
Total	**9,000**	**81,000**	**90,000**	**100.00%**

The 2015 gift tax returns did not disclose the sales.

In its gift tax audit, the IRS increased each brother's gift tax liability to approximately $13.57 million for the 2014 and 2015 tax years and penalties of $5.43 million.[36]

The IRS's main argument was that the *Wandy*-like defined value clause should not be respected.

[36] Firehouse was eventually sold in 2021 for $1 billion cash, which was allocated among the shareholders, the trusts received approximately $153 million each.

First, the IRS argued that the donors relinquished dominion and control of 9,385 shares on December 31, 2014. The IRS based this argument on a number of acts: (1) he company reported that each trust owned 9,385 shares on its stock ledgers and on income tax returns; (2) the trusts received pro rata distributions based on ownership of 9,385 shares; (3) the trusts never agreed to transfer shares based on the defined value formula and did not countersign the stock powers, which described the transfers as defined value formula transfers; and (3) the trusts transferred 9,385 shares each to the third-party purchaser, who paid the trusts for those shares.

The IRS's Pretrial Memorandum included an analogy to a defined value gift of cows

> Consider that if a farmer agrees to transfer his son [sic] several cows worth $1,000 as finally determined for federal gift tax purposes, and the farmer's appraiser determines that five cows equal that value, then the transfer is for five cows. The son is now the owner of five cows. Years pass. The son breeds the cows and opens a barbeque stand. If a later gift tax examination finds that each cow was actually worth more, and that two extra cows had been included in the transfer, nothing in the agreement would allow the farmer to take the two cows back. They were sold as barbeque. The parties might be held to their agreement – a transfer of the number of cows as finally determined to equal $1,000 coupled with the possibility of the farmer getting something (barbeque?) in the event of a redetermination of value. But whatever it is, it won't be the cows transferred. And it might be nothing; the farmer may not pursue his claim, and if he does, he is now just a general creditor who must stand in line with all the other unsecured creditors of the barbecue operation.
>
> The farmer's use of a transfer clause that contemplates subsequent events does not change the fact that the transfer of the five cows was complete on the execution of the documents. This is the case even though the number of cows was indefinite until the initial appraisal was completed. The transfer was of five cows, regardless of whether the transfer is structured as a gift or a sale.
>
> Under the farmer's transfer document, however, a redetermination of the value of a cow might give rise to a right of recovery against the son. But a right that is dependent upon the occurrence of an event beyond the donor's control, such as a later redetermination of value by federal authorities or the courts, does not alter the fact that the transfer is complete for gift tax purposes upon the execution of the documents. The possibility that the farmer might get something back does not change the fact that he transferred five cows upon the execution of the documents, regardless of whether the transfer is structured as a gift or a sale.

The IRS also argued that the language in the stock power attempting to "adjust" the number of shares transferred is a condition subsequent and violated public policy, based on *Commissioner v. Procter*. The IRS has previously distinguished formula allocation clauses in which the transferor clearly transferred all of a specific block of shares or interests (*Procter*), and the formula clause allocates the block between two recipients (and the transfer to one of those recipients would not result in a taxable gift). Those types of clauses have been approved in *McCord v. Commissioner; Estate of Petter v. Commissioner, and Hendrix v. Commissioner*.

The *Wandry* decision had reasoned that a savings clause is void because it creates a donor that tries to "take property back," but held that the transfer document in question in that case reflected the intent to transfer "a predefined … percentage interest expressed through a formula" to each done. The transfer document did not allow taxpayers to "take property back" but only to correct the allocations.

The IRS's Pretrial Memorandum summarized its criticism of Wandry:

> The *Wandry* opinion improperly focused on the donors' intent rather than the donors' relinquishment of dominion and control over gifted property, as required by the statutes and regulations thereunder. Therefore, to the extent necessary to resolve this issue, this Court should find *Wandry* was wrongly decided, and petitioners owe additional gift tax to the extent that the value of 9,385 nonvoting shares of FRG [Firehouse Restaurant Group] exceeds petitioner's annual exclusions and lifetime exemption equivalents."

The IRS also argued that the facts of *Sorensen* were distinguishable from those of *Wandry*. In *Wandry*, the court noted that the number of LLC units initially transferred was unclear from the record before the court. The IRS argued that in *Sorensen* the shares were clearly gifted and the benefits attributable to those shares were shifted. Furthermore, unlike the donors in *Wandry*, the *Sorensen* donors failed to follow their own transfer clauses. Based on the appraised value, $5.0 million worth of shares would have been 9,384.56 shares, but (contrary to their attorney's advice) the donors for administrative simplicity rounded that to 9.385 shares. The IRS also argued that the shares transferred could not be adjusted because of the sale of all shares to a third party and because the taxpayers had stipulated that each brother had gifted 9,385 shares.

19) Estate of Fulton v. Commissioner – US Tax Court (Pending)

Stanley Fulton (the "Decedent") and Betty Fulton were married in 1953 and had 6 children together. In 1977, after their marriage had fallen apart, the Decedent and Betty entered into a property settlement agreement (the "Agreement"). Under the Agreement, Betty would receive the following:

a) $2,000/month alimony for 250 months (or until death or remarriage);
b) $20,000 lump sum payment;
c) Promissory note with principal amount of $480,000 and 5% interest with principal due upon sale of Decedent's business interests on or before February 15, 2003;
d) Her clothes, jewelry, car, and personal effects
e) One-half of all jointly owned household goods and furnishings

Under the Agreement, the Decedent retained his personal effects, all jointly owned property, all other personal and real property and all business interests.

The Decedent and Betty also agreed that 2/3 of each of their respective net estates would pass to their children.

In 2017, after Betty had died, Decedent executed a Will and Amended and Restated Trust Agreement. Under his Will, the Decedent left all of his tangible personal property to his children, and the balance of his estate to his revocable trust. The Trust Agreement instructed the trustee to make $1 million distributes to six of the Decedent's friends, pass voting interests in a racetrack and casino to separate trust for the benefit of Decedent's children, and the rest to the Stanley E. Fulton Family Foundation. This plan did not comply with the Settlement Agreement.

The Decedent died in January 2018 and on May 31, 2018, each of the six children filed a creditor claims against the estate and the revocable trust to enforce the Decedent's obligations under the Settlement Agreement. Each claim was in the amount of $82,333,333. The claims were resolved through a family settlement agreement.

The Decedent's estate tax return was timely-filed, on extension, in January 2019. The return showed the following items.

1. Gross Estate:	$857,695,568
2. Total Incomplete Gifts:	$10,000
3. Total Specific Gifts:	$79,931,000
4. Debts, Expenses and Taxes:	$480,312,886
5. Residuary Estate:	$297,441,682

Of the $480,312,886 amount for Debts, Expenses and Taxes listed on the Estate Tax Return, $472,530,178 was attributable to the creditor claims, $1,875,036 was attributable to administration expenses, and $5,907,672 was attributable to taxes.

Not surprisingly, the IRS completely disallowed the $472 million deduction for settlement of the children's claims. On January 6, 2002, it issued a Notice of Deficiency imposing an additional estate tax liability of $214,662,063 and penalties of $42,924,413.

The Estate is arguing that the claims were valid, deductible claims against the estate because the agreement between Decedent and Betty was based on adequate and full consideration in money or money's worth. The Estate's position is that Betty gave up substantial and valuable rights in order to induce Decedent to agree to leave two-thirds of his estate to the kids, noting that she would have received significantly more property under state law had she not negotiated for the bequest in favor of the children.

The IRS appears to be looking at this case as a will contest (not deductible) rather than a bona fide debt of the estate. However, the facts support the argument that was an bona fide agreement, with no donative intent, especially as it was made so long before the taxpayer's death.

Certainly, this argument leaves the door wide open for taxpayer abuse. It is not difficult to think of a situation where a cunning planner could artificially create this type of debt in order to obtain the estate tax deduction. This will be a case to watch.

20) Planning Techniques.

This section discusses planning techniques available to clients who are interested in transitioning wealth to the next generation and taking advantage of higher exemption rates while they are available.

a) ***Basic Planning***. Although this likely goes without saying, advisers should ensure that clients have engaged in basic estate planning, including the execution of proper testamentary documents and powers of attorney. It is not uncommon for a client to approach an initial meeting ready to dive into complex estate planning strategies even though the client has not initially taken steps to complete basic planning. Just as important as ensuring basic planning has been completed is the need to ensure that the testamentary plan is updated after any lifetime strategies are implemented. If a client opts to create a generation-skipping trust during lifetime and allocate generation-skipping tax exemption to that trust, then the testamentary plan should likely be updated to take this into account (and can often be simplified to incorporate these trusts created during lifetime into the testamentary documents rather than using newly created trusts under those documents).

b) ***Basic Elements of Lifetime Strategies***. Advisers should keep in mind the following underpinnings of lifetime strategies to ensure that they are as effective as possible:

i) ***Utilize Discounts***. Where possible, transfer interests in property or business interests that will be eligible for minority, lack of control and/or lack of marketability discounts. Together, these discounts can, in certain circumstances, exceed 20% or more of the appraised value of transferred property. For example, if a business is worth $25 million and the client wishes to fund a lifetime trust with business interests, the client could transfer 49% of the ownership of the company to the trust and, with appropriate discounts, report a gift of under $10 million even though it effectively removes $12.25 million from the client's estate.

ii) ***Transfer Appreciating Property***. Where possible, clients should transfer appreciating property when making lifetime gifts. Transferring appreciating assets not only removes the current value of the assets from the client's estate, it also removes the future appreciation attributable to the gifted asset(s) from the client's estate. For instance, if a client owns an asset that is projected to appreciate 50% over the client's remaining lifetime and it is currently worth $20,000,000, then a gift of that asset today will remove not just $20,000,000 from the client's estate, but an additional $10,000,000 that could not have been gifted without incurring gift tax. Combine this with discounts, and the client is able to transfer even more value at a lower cost.

iii) ***Utilize Grantor Trusts***. Code Sections 671 through 679 treat grantors of trusts as the owners of the trusts under certain circumstances. The tax result is that the grantor includes all tax items associated with the trust on the grantor's tax return. Grantor trust status can be incredibly beneficial for the following primary reasons: (i) the payment of income tax on a trust's income is a gift tax free gift that enables the trust to continue growing without the burden of income tax; (ii) the tax payments will further reduce the grantor's estate; and (iii) grantor trust status enables future planning techniques, such as sales to the grantor trust, without adverse tax consequences because for tax purposes the grantor and the trust are the same taxpayer. Common methods of achieving grantor trust status include, among others, the retention of the non-fiduciary right to reacquire assets of equivalent value, the right of the Trustee to pay premiums on life insurance using the income of the trust and the power to lend trust assets to the grantor without adequate security.

iv) ***Formula Clauses***. Where clients are attempting to transfer a specific dollar amount like the client's remaining lifetime exemption of a hard to value asset (e.g., an interest in a closely-held business entity), advisers and clients should consider the use of a formula clause when making the gift. As advisers are well aware, gifts of this nature are subject to audit by the IRS and an audit can result in a drastically different valuation than the valuation obtained by the client in an appraisal. If an audit results in an increased valuation and the client transferred a specific number of shares or a specific percentage interest in the closely-held entity, then the finally determined value of that interest will result in a larger gift which could result in the imposition of gift tax. A formula clause, such as a *Wandry*[37] clause, phrases a transfer in the terms of value. For instance, a *Wandry* clause transfers that percentage of the donor's membership interest that has a value equal to $12,090,000 on the effective date of the transfer. When a clause of this nature exists, an increased valuation of the underlying company does not change the value of the gift because the total value of the gift is capped. Instead, the percentage interest transferred is decreased and that change is noted on the books of the company. These clauses provide great upside protection for assets that are subject to significantly different valuations. For clients who are charitably inclined, approved formula

[37] *See Estate of Wandry v. Comm'r*, T.C. Memo 2018-88 (March 26, 2012).

clauses exist that would transfer any excess over a certain defined amount to a charitable entity.[38]

c) ***Outright Gifts***. If a client is not concerned with generation-skipping planning or retaining some level of control or direction over an asset or is simply one of those clients who abhor complicated estate planning strategies, then the client may elect to simply make outright gifts of property to family members. Large outright gifts may be appropriate in some instances and discounts can still be used for these types of gifts. Many clients, however, will opt to utilize trusts for planning to be able to control how those assets benefit family members in the future and to protect the assets from creditors of beneficiaries (including spouses of beneficiaries) and to provide a legacy that will last for multiple generations (rather than being squandered by a descendant during his or her lifetime).

d) ***Spousal Lifetime Access Trusts***. Spousal Lifetime Access Trusts ("SLATs") have become incredibly popular over the past decade. They were often utilized in 2012 when individuals intended to utilize their remaining lifetime exemption amount with the scheduled decrease of the estate tax exemption the following year. SLATs are described below.

i) ***Description***. A SLAT is an irrevocable trust created by one spouse (the "donor-spouse") for the benefit of the other spouse (the "beneficiary-spouse") and other beneficiaries the donor-spouse identifies, if any. Although a SLAT's structure can vary depending on client preference, a SLAT generally grants the Trustee discretion to distribute income and principal for the benefit of the beneficiary-spouse and any other named beneficiaries. The SLAT can also be restricted to only benefit the beneficiary-spouse during his or her lifetime or to emphasize that the beneficiary-spouse is to be considered the primary beneficiary of the SLAT.

ii) ***Benefits***. SLATs offer the following benefits:

(1) A SLAT may be used to take advantage of high gift tax exemptions before they expire under current law, while allowing the beneficiary-spouse to continue to use and enjoy the assets irrevocably gifted by the donor-spouse.

(2) A SLAT removes appreciation on the contributed assets from the donor-spouse's estate.

(3) A SLAT offers protection from the beneficiary-spouse's creditors.

(4) A SLAT is a "Grantor Trust" for income tax purposes, which results in all income being taxed to the donor-spouse, provides the

[38] *See Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. 2009), and *Estate of Petter v. Comm'r*, 598 F.3d 1191 (9th Cir. 2011).

benefits described above and will enable the donor-spouse to engage in transactions with the SLAT at a later time, if desired.

iii) ***Risks***. Risks with SLATs are as follows:

(1) ***Reciprocal Trust Doctrine***. If each spouse creates a SLAT for the other and the SLATs are too similar, the IRS could utilize the reciprocal trust doctrine to unwind the transaction such that it is treated as if each spouse created a trust for his or her own benefit, which would cause estate tax inclusion of the trust assets. Some methods of differentiating SLATs are as follows:

(a) Create and fund the trusts at separate times;

(b) Utilize different trustee appointments (e.g., name an independent third party as the trustee of one trust or utilize Co-Trustees for one trust);

(c) Incorporate a power of appointment in one trust but not the other; or

(d) Utilize different beneficiaries for each trust (e.g., name the spouse and issue as beneficiaries of one trust and just the spouse as the beneficiary of the other trust).

The more differences that are created between the trusts, the more likely it would be to withstand IRS scrutiny. Unfortunately, there is not significant case law in this area, so no strategy can be guaranteed protection from IRS scrutiny.

(2) ***Divorce***. One question clients usually ask is, "What happens if we get divorced?" That is certainly a risk. If a SLAT is created for a spouse and then the couple subsequently divorces, unless appropriate provisions are included in the trust agreement, the ex-spouse will continue to benefit from the SLAT. One option is to provide that the SLAT will terminate as to the beneficiary-spouse and be divided among issue upon the earlier of the beneficiary-spouse's death or a divorce or separation.

iv) ***Example***. Donor-spouse transfers $12,920,000 in marketable securities to a new SLAT for the benefit of beneficiary-spouse. Assuming the SLAT has a 7% growth rate, after 15 years the value of the SLAT (not taking into account distributions) will have grown to $35,646,688, which represents $22,726,688 in appreciation and an estate tax savings of $9,090,675 (at the current 40% tax rate).[39]

e) ***Generation-Skipping Trusts***. If a client has sufficient wealth and the client is not concerned with maintaining access to a gift (as with a SLAT), then the client may be more interested in implementing a trust plan that provides for descendants via a generation-skipping transfer tax exempt dynasty trust. This strategy is briefly described below.

i) ***Description***. A trust of this nature may initially provide for a "pot trust" that benefits the client's children until all of the children attain a certain age or some other predefined event (e.g., the decision of an individual to terminate the "pot trust" or the death of the client). Upon termination of the "pot trust," the assets are usually divided into separate generation-skipping trusts for the children and their issue. Each child's trust will terminate upon the child's death and be divided into separate generation-skipping trusts for each of the child's children. This division will continue in perpetuity (for a jurisdiction that has abolished the rule against perpetuities) or until the assets are diminished or the Trustee opts to distribute all of the assets outright.

ii) ***Benefits***. Generation-skipping trusts offer the following benefits:

(1) The client utilizes the client's remaining estate, gift and generation-skipping transfer tax exemptions.

(2) If the trust is structured as a grantor trust, it will continue to grow income-tax free and can be utilized for more advanced planning techniques in the future.

(3) Because the assets will remain in trust for each successive generation, the assets will be sheltered from transfer taxes at the transition of each generation. This will enable the trust assets to avoid tax rates as high as 40% or more that would likely be incurred if the assets were owned by beneficiaries outright.

(4) The trust assets may be sheltered from the claims of the beneficiaries' creditors.

iii) ***Risks***. Assuming that the trust is properly drafted to avoid retained powers by the client that could result in estate tax inclusion, this strategy is fairly benign. Aside from the risk of a retroactive tax law, the major risk would be the risk of a valuation adjustment if the gift tax return is audited. That risk, however, can be mitigated with an appropriate formula clause.

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[39] Note that this calculation ignores distributions made from the trust and any taxes paid by the trust during the fifteen-year period.

f) ***GRATs***. GRATs offer a great opportunity for clients to transfer appreciation on assets outside of the client's estate.

i) ***Description***. A GRAT is an estate freeze technique that allows a client to "freeze" the value of assets in the client's estate while transferring assets to the next generation at a reduced transfer tax cost. With a GRAT, the client retains an annuity interest in the property transferred to the trust during the term of the GRAT (often a short-term period of two years). The annuity amount, which is customarily defined as a percentage of the initial funding value of the GRAT plus a minimum rate of return based on the Code Section 7520 Rate, is paid to the client each year. Any assets remaining at the end of the GRAT's term will be distributed to the remainder beneficiaries. GRATs can be used in conjunction with other trusts such that the remainder is distributed to another trust. Alternatively, continuing trusts can be created under the GRAT. GRATs are most effective when the Code Section 7520 Rate is low, as it currently is, because the annuity amount that must be paid to the client is based on the Code Section 7520 Rate. The lower the required annuity is, the greater the remainder interest will be and the more successful the GRAT will be.

ii) ***Benefits.*** GRATs offer the following benefits:

(1) A GRAT can be structured to reduce a gift to zero (or close to zero) which does not reduce the client's lifetime exemption.

(2) A GRAT freezes the value of assets in the client's estate by removing appreciation attributable to the contributed assets.

(3) Appreciation passes gift-tax free to remainder beneficiaries.

(4) GRATs are "Grantor Trusts" for income tax purposes, which results in all income being taxed to the client, which provides the benefits described above.

iii) ***Risk***. If the GRAT underperforms (does not beat the Code Section 7520 Rate) or if the client dies during the term, all of the assets contributed to the GRAT will be included in the client's estate—the same result as if the GRAT had not been created.

iv) ***Additional GRAT Strategies***. The traditional GRAT strategy can be amplified with the following strategies:

(1) ***Rolling GRATs***. The client may choose to roll each annuity received into a new GRAT each year, which is often identical to the original GRAT. Additional assets can be added to the annuity payment to reach a desired funding amount. This will ensure all appreciation associated with the assets continue to be transferred out of the client's estate.

(2) ***GRATs by Asset Class or Type***. Whether a GRAT is successful entirely depends on the return generated by the assets within the GRAT. Many clients seek to optimize the performance of GRATs by creating multiple GRATs with each GRAT holding a specific asset class or type. The rationale is that if one asset type underperforms, it will not negatively affect a GRAT that would otherwise perform well based on the other assets. If a GRAT underperforms, there simply will not be any assets remaining for the distribution to the remainder beneficiaries after payment of the required annuity.

v) ***Example***. Client transfers $3,000,000 in marketable securities to a new GRAT in February 2023 when the 7520 Rate is 4.6%. The GRAT has a two-year term and an assumed 7% growth rate. The GRAT results in a taxable gift of $0.01, an annual annuity payment to the donor of $1,604,278.07, and a tax-free distribution of $113,844.40 to the remainder beneficiaries.

g) ***Sale to an Intentionally Defective Grantor Trust***. A sale to an intentionally defective grantor trust (an "IDGT") is another strategy that is not intended to utilize remaining lifetime exemption and, therefore, is a strategy that may be considered by a client who is concerned about the risk of retroactive tax legislation. A description of this strategy is included below.

i) ***Description***. A sale to an IDGT is an estate freeze technique that allows a client to transfer an asset's future appreciation to the next generation with no transfer tax cost. This strategy requires the creation of the IDGT by the client, a "seed" gift[40] by the client to fund the IDGT, and a subsequent sale of an asset to the IDGT by the client. The IDGT is typically structured to benefit the client's spouse and/or the client's descendants. Because the IDGT is a "Grantor trust," the client may engage in transactions with the IDGT without income tax consequences. After creation and funding of the IDGT, the client sells an asset to the IDGT for fair market value in exchange for a promissory note with interest payable to the client at the AFR. Typically, the asset sold to the IDGT (often an interest in an LLC or partnership) receives discounts for lack of marketability and lack of control. In addition, it is customary for the promissory note to require interest-only payments with a balloon payment of principal at the end of the term. If the asset is sold at a discount, and the asset generates a rate of return while owned by the IDGT that is greater than the interest rate charged on the promissory note, the client is able to transfer wealth to the IDGT free of gift tax. The IDGT is designed to avoid estate inclusion for the client. With the AFR rate at a historic low, having a return that is greater than the interest rate is simpler than it has been in the past.

[40] The "seed" gift is, generally, 10% of the value of the asset to be sold to the IDGT.

ii) ***Benefits***. The benefits for a sale to an IDGT are as follows:

(1) A sale to an IDGT freezes the value of assets in the client's estate by transferring the assets to the IDGT in exchange for a promissory note of equivalent face value. Appreciation on the sole asset passes gift-tax free to the trust beneficiaries.

(2) IDGTs are "Grantor trusts" for income tax purposes, which provides the benefits described above.

(3) A client's generation-skipping transfer tax exemption may be allocated to the IDGT upon funding to maximize future transfer tax benefits of the IDGT.

(4) The interest payments made by the IDGT to the client are not taxable income to the client because the payments are technically being made from the client, as the IDGT for tax purposes, and to the client, individually.

iii) ***Risk***. If the client dies during the term of the note, the outstanding value of the promissory note will be included in the grantor's estate.

iv) ***Example***. Client sells a membership interest in an LLC valued at $1,000,000 to an IDGT in exchange for a promissory note requiring interest-only annual payments using the mid-term AFR of 0.58%. The promissory note has a nine-year term and the membership interest sold to the IDGT has an assumed 5.0% rate of return each year. At the end of the term, the membership interest has grown to a value of $1,487,374.14 as compared to the $1,000,000 debt the IDGT must repay to the client. This appreciation avoids approximately $194,949.66 in gift tax (assuming the current 40% tax rate) and removes the membership interest's future income and appreciation from the client's estate.

h) ***Intra-Family Loans***. In this low-rate environment, intra-family loans are a great tool to give family members the benefit of a client's wealth at little-to-no cost. Note that this strategy is not intended to utilize lifetime exemption. A brief description is included below.

i) ***Description***. An intra-family loan may be considered an estate freeze technique that allows a client (the lender) to "freeze" the value of assets in the lender's estate while transferring assets to the next generation at no transfer tax cost. The IRS-approved interest rate used for intra-family loans is the AFR. The IRS assigns AFRs based on the term of the loan: short-term (less than three years), mid-term (between three and nine years) and long-term (longer than nine years). Intra-family loans can be used by the borrower for any purpose, including to purchase a home, start a business, or otherwise invest. When the borrower earns a rate of return in excess of the AFR, the loan has a similar effect as a transfer of wealth from the lender to the borrower but without gift tax consequences. Note that an alternative strategy of refinancing existing intra-family loans using today's low AFRs can reduce the cost of capital for a related borrower and minimize income taxable to the lender.

An intra-family loan is documented using a promissory note that can be structured to require interest-only payments with a balloon principal payment at the end of the term, or amortized with traditional installment payments of principal and interest. Collateral is not required but may be recommended depending on the circumstances.

ii) ***Benefits***. Benefits of intra-family loans are as follows:

(1) The borrower obtains a low-interest loan and pays interest to a family member, as opposed to a commercial lender.

(2) If the borrower obtains a rate of return higher than the interest rate charged, wealth transfer benefits occur without transfer taxes.

(3) The lender may be able to forgive a portion of the loan each year using the lender's gift tax annual exclusion ($15,000) or lifetime exemption ($11,700,000 million).

iii) ***Risk***. The loan must be documented properly and administered according to its terms. Otherwise, the loan may be deemed a gift and taxed accordingly.

iv) ***Example***. Parent makes a $1,000,000 interest-only loan to a child for a term of eight years using the 0.52% AFR. The child invests the loan proceeds in securities and obtains a 5% rate of return each year during the loan term. At the end of eight years, the parent has received interest income of $41,400, the child has earned $436,055 in net appreciation, and the parent has avoided gift tax on the net appreciation of approximately $174,422.