Steve Leimberg's Estate Planning Email Newsletter - Archive Message #3029

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From: Steve Leimberg's Estate Planning Newsletter

Subject: Martin M. Shenkman, Jonathan G. Blattmachr & Joy Matak: Analysis of the Biden Administration's Fiscal Year 2024 Revenue Proposals

In their commentary, **Martin M. Shenkman**, **Jonathan G. Blattmachr** and **Joy Matak** provide **LISI** Members with their analysis of the Biden Administration's Fiscal Year 2024 Revenue Proposals. Members who wish to learn more about this topic should consider registering for the following **LISI** Webinar where Marty and Jonathan were joined by **Alan Gassman** and **Bob Keebler**: A First Look at the Radical Estate Tax Changes Contained in the Biden 2024 Budget: Urgent Impact on High Net Worth Families!

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and more than 1,200 articles. He is a member of the NAEPC Board of Directors (Emeritus), on the Board of the American Brain Foundation, the American Cancer Society's National Professional Advisor Network and Weill Cornell Medicine Professional Advisory Council.

Joy Matak, JD, LLM is a Partner at Sax and head of the firm's Trust and Estate Practice. She has more than 20 years of diversified experience as a wealth transfer strategist with an extensive background in recommending and implementing advantageous tax strategies for multi-generational wealth families, owners of closely held businesses, and high-net-worth individuals including complex trust and estate planning. Joy presents at numerous events on topics relevant to wealth transfer strategists including engagements for the ABA Real Property, Trust and Estate Law Section; *Wealth Management Magazine*; the Estate Planning Council of Northern New Jersey; and the Society of Financial Service Professionals. Joy has authored and co-authored articles for the *Tax Management Estates, Gifts and Trusts (BNA) Journa*l; Leimberg Information Services, Inc. (LISI); and *Estate Planning Review– The CCH Journal*, among others, on a variety of topics including wealth transfer strategies, income taxation of trusts and estates, and business succession planning. Joy recently co-authored a book on the new tax reform law entitled *Estate Planning: Estate, Tax and Other Planning after the Tax Cuts and Jobs Act of 2017*.

Jonathan G. Blattmachr is author or co-author of several books and many articles. He is a director at **Pioneer Wealth Partners LLC**, director of estate planning for the **Peak Trust Company** and co-developer with Michael L. Graham, Esq., of Dallas, Texas of **Wealth Transfer Planning.** He is co-author with Georgiana J. Slade, Esq., and Diana S.C. Zeydel. Esq., of Bloomberg Tax Management Portfolio 836-3rd (Partial Interests--GRATs, GRUTs, and QPRTs (Section 2702)).

Here is their commentary:

General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals Analysis and Discussions

By: Martin M. Shenkman, Jonathan G. Blattmachr and Joy Matak

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16. The Value Of Transferred Property For Transfer Tax Purposes

1. Introduction to the Greenbook.

a. President Biden has issued his budget on March 9, 2023, the "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals Analysis and Discussions," known as the "Greenbook." The estate tax provisions of the Greenbook are reviewed below. These provisions are in some ways even more extensive and harsh than the some of the prior proposals, e.g., the most recent ones proposed by Senator Sanders.
b. Secretary of the Treasury Janet L. Yellen said: "This Budget builds on our economic progress by making smart, fiscally responsible investments, which would be more than fully paid for by requiring corporations and the wealthy to pay their fair share. The Budget's growth-enhancing investments will continue the economic progress of the last two years and further boost the economy's productive capacity."
c. A stated goal of the estate tax proposals in the Greenbook are: "Close estate and gift tax loopholes that allow the wealthy to reduce their tax by using complicated trust arrangements to transfer their assets to their heirs."
d. While many believe that these changes cannot be enacted in the current environment that may be a mistaken assumption. With debt ceiling negotiations there is no certainty as to what types of negotiations or compromises may be made.
e. On March 20, 2023, Senators Elizabeth Warren, Bernard Sanders, Chris Van Hollen and Sheldon Whitehouse wrote a letter to Janet Yellen Secretary of the Department of the Treasury encouraging her to "…use your existing authority to limit the ultra-wealthy's abuse of trusts to avoid paying taxes. Billionaires and multi-millionaires
use trusts to shift wealth to their heirs tax-
free, dodging federal estate and gift taxes." The letter goes on to detail various loopholes and abuses that they believed should be acted upon. Shortly after the sending of the above letter, Revenue Ruling 2023-02 below was issued.
f. Revenue Ruling 2023-02 confirms that the basis adjustment under section 1014 generally does not apply to the assets of an

irrevocable grantor trust not included in the deceased grantor's gross estate for Federal estate tax purposes.[i]

g. So, while many may dismiss any possibility of restrictive estate tax legislation as fanciful with a Republican controlled House, there really is no assurance that change may not occur.
h. A note on the format of the materials below. These materials endeavored to organize the Greenbook materials on each topic sequentially. The actual Greenbook generally presented a series of different issues first, then discussed the current law on each of those, and thereafter set forth the proposals and effective dates. Organizing each matter in a consecutive order makes it much easier to read. Some topics, e.g., GST items, appeared in a different order in the Greenbook and those were organized in one area. Some changes were made to the Greenbook language, a few comments added, and footnotes generally omitted. Our comments as to the possible implications or issues follow at the end of each individual topic. It was hoped that this approach would make this analysis a practical tool for practitioners, rather than merely presenting our analysis so that readers would have to refer back to the various portions of the Greenbook for the actual issues and proposals.

2. What Might Practitioners Do?
    a. It would seem prudent for practitioners to communicate to clients that significant estate tax revisions have been proposed. There are other areas which are addressed in the Greenbook but not discussed in this article.
    b. It is difficult to recommend what actions might be taken without knowing the form of any final legislation, or whether anything will even be enacted. Also, many of the proposed changes, as discussed in detail below, are effective without regard to when trusts or certain planning steps were created. However, the ability to create a grantor trust with certain tax attributes, or to consummate a note sale transaction without triggering gain, etc. will be permitted before the date of enactment but not after. Therefore, for many clients it might be prudent to complete certain planning sooner rather than later, to avoid the proposed restrictions. If that planning is prudent regardless of whether or not any of the proposals are enacted, there is no reason to delay and potentially risk being precluded from completing it.

c. Practically speaking, however, after the repeated warnings practitioners gave to clients about threatened or proposed legislative changes in 2020 and 2021 it is unlikely many clients will be swayed to act because of yet another tax proposal. But that decision really should be made by clients, not practitioners. So, communicating in at least general terms that harsh proposals have yet again been proposed, as well as the risks of the Treasury taking action even if legislation cannot be enacted, to clients might be advisable.

3. Definition of Executor.
   a. **Perceived Issue**. Sec. 2203 defines "executor" for purposes of the estate tax as the person appointed, qualified, and acting as executor or administrator of the decedent's estate or, if none, then "any person in actual or constructive possession of any property of the decedent" who is considered a "statutory" executor. A "statutory" executor is a person who is not appointed by a court but has an obligation to file an estate tax return because they possess assets of the decedent. A statutory executor could include, for example, the trustee of the decedent's revocable trust, a beneficiary of an individual retirement account (IRA) or life insurance policy, or a surviving joint tenant of jointly owned property. It is unclear, however, whether a named beneficiary of an insurance policy or IRA will be deemed under these rules to be in "possession" of it so that they would be saddled with the mantle of executor under this change. Because the statutory definition of executor applies only for estate tax purposes, statutory executor (including a surviving spouse who filed a joint income tax return) has no authority to represent the decedent or the estate with regard to the decedent's final income tax liabilities, failures to report foreign assets, or other tax liabilities and obligations that arose before the decedent's death. Similarly, no one has the authority to extend a limitations statute, claim a refund, agree to a compromise or assessment, or pursue judicial relief with regard to a tax liability of the decedent. Because reporting obligations (particularly regarding interests in foreign assets or accounts) have increased, problems associated with this absence of any representative authority are arising more frequently. Additionally, in the absence of an appointed executor, multiple persons may meet the definition of executor and, on occasion,

multiple persons have filed separate estate tax returns for the decedent's estate or have made conflicting tax elections.

b. **Proposal**. The proposal would move the existing definition of executor from section 2203 to section 7701 of the Code, expressly making it applicable for all tax purposes, and would authorize such an executor to do anything on behalf of the decedent in connection with the decedent's pre-death tax liabilities or other tax obligations that the decedent could have done if still living. Because this definition frequently results in multiple parties being characterized as executors, the proposal also would grant regulatory authority to the Secretary to adopt rules to resolve conflicts among multiple executors authorized by that provision. Another consideration is how state law rules governing the appointment of, or designation of, a personal representative would affect this.
c. **Effective Date**. The proposal would apply upon enactment.
d. **Comments**.
    i. The issue is a gap in who can assume broader responsibility for all of a decedent's tax reporting and related matters. Further, resolving issues of who should be designated as personal representative when the decedent dies intestate makes sense. It is estimated that 68% of people die without a will.[ii] These changes seem practical, and once Regulations are issued will provide clarity as to who has responsibility for a wide range of tax reporting and other matters. That will be helpful to tax practitioners endeavoring to help address a range of tax compliance and related matters.
    ii. A potential issue with this change, if enacted, is it appears that it may significantly increase the responsibility and hence liability of the person designated as "executor." Whereas a person accepting the role of executor today knows that their liability is limited to administering the estate and filing an estate tax return. Likely the executor may have assumed responsibility for the decedent's final income tax return as well. However, this expansion of the scope of all of the definition and responsibilities of the person designated as executor will include the responsibility to address failures to report foreign assets with the significant potential penalties for failure to

properly report foreign assets, and perhaps the challenges in some instances to even identify those assets, this may raise a concern for executors.

iii. The proposal will also make the newly expanded "executor" responsible for "other tax liabilities and obligations that arose before the decedent's death." What might that encompass? As but one example, an: "…estimated that 75% to 95% of people who employ nannies, sitters, housekeepers, and home health aides don't bother paying employment taxes…" [iii]

iv. Will this proposal surreptitiously increase an executors responsibility for past due nanny taxes? What about insurance for executors? If the role, responsibilities and liability is expanded how will insurance carriers offering executor liability coverage respond? What might happen to premiums? Also, will this expanded definition create issues such that more executors will want to purchase insurance coverage? Certainly, it may be more advisable for practitioners to advise executors to obtain executor liability coverage.

v. There is another concern with all of this. It might be likely that a successor executor under a decedent's revocable trust would realize that they are to serve as executor of the estate if the decedent's will does not name an executor. In contrast, however, it would seem that under current law a person receiving a life insurance policy or IRA as a designated beneficiary would likely not be willing to assume responsibility for being the executor for the decedent's estate. They, in contrast to the successor trustee under the decedent's revocable trust would not imagine they have any responsibility other than taking the money bequeathed to them under a beneficairy designation form. But the new law might make such an unsuspecting beneficiary the official executor for the estate with all the attendant liability of an executor. Will that be a trap for the unwary and how will those unknowing executors even become aware of their responsibilities? Further, if the beneficiary of an IRA falls within the ambit of the new definition of executor under the Greenbook proposal would not only be responsible for

filing an estate tax return but also unpaid income taxes. Might these reporting obligations extend to unpaid nanny or home health aide payroll taxes? Might they apply to reporting foreign assets they may have known nothing about?

4. Limit On The Reduction In Value Of Special Use Property.
    a. **Perceived Issue**. Generally, the fair market value of real property for estate tax purposes is based on the property's value at its "highest and best use." For example, an undeveloped parcel of land might be valued as property that could be developed for residential or commercial purposes. However, the estates of owners of certain real property used in a family-owned trade or business (e.g., a farm) may reduce the value of that property for Federal estate tax purposes, pursuant to Sec. 2032A, below its highest and best use value to help preserve its current use. The maximum reduction in value is limited to $750,000, as adjusted for inflation since 1997; in 2023, the reduction in value is capped at $1.31 million. The inflation adjustments since 1997 have not kept up with the increases in the value of real property over that same period, causing this special use valuation provision to be of diminishing benefit to decedents' estates.
    b. **Proposal**. The proposal would increase the cap on the maximum valuation decrease for "qualified real property" elected to be treated as special use property to $13 million. Such property generally would include the real estate used in family farms, ranches, timberland, and similar enterprises.
    c. **Effective Date**. The proposal would apply to the estates of decedents dying on or after the date of enactment.
    d. **Comments**.

        i. The provisions in Sec. 2032A "Special Use Valuation" permit real property to be appraised as it is actually used(e.g., as farmland), rather than at development value when determining estate taxes. That provides a reduction in value to minimize estate taxes on farms and closely held business operations to permit succession planning.

        ii. The new proposal is a whopping figure of $13 million, approximately what the current estate tax exemption is. Rounding the estate tax exemption to $13 million this

doubles what an individual can pass to heirs. For a married couple trying to pass on farmland that might mean in 2024 that $13 million x 3 (2 exemptions and 1 special use valuation reduction) of value, or nearly $40 million (assuming no discounts) can be passed on to heirs estate tax free. It does not appear that this reduction will be reduced in 2026 when the exemption is reduced. That is a tremendous boon to farmers, ranchers and qualifying closely held businesses.

iii. The average farm size was 445 acres in the U.S.[iv] The average U.S. cropland value in 2022 was $5,050 per acre.[v] So the average farm value is about $2,247,250 but the average farming couple can pass on nearly $40 million of farmland.

iv. Perhaps, the next great estate tax shelter is to buy farmland.

v. This valuation rule, coupled with the large exemptions (even after 2026) might suggest that planning for farm, ranch and other qualifying assets that will be non-taxable should be based on retaining those assets in the estate if there will be a step up on death without triggering estate tax.

5. Duration Of Certain Estate And Gift Tax Liens.

   a. **Perceived Issue**. Current law provides an automatic lien on all gifts made by a donor and generally on all property in a decedent's estate to enforce the collection of gift and estate tax liabilities from the donor or the decedent's estate. The lien remains in effect for 10 years from the date of the gift for gift tax, or the date of the decedent's death for estate tax, unless the tax is paid in full sooner. Currently, this 10-year lien cannot be extended, including in cases where the taxpayer enters into an agreement with the Internal Revenue Service ("IRS") to defer tax payments or to pay taxes in installments that extend beyond 10 years. Thus, for unpaid amounts due to be paid after the 10-year period, this special lien has no effect.

   b. **Proposal**. The proposal would extend the duration of the automatic lien beyond the current 10-year period to continue during any deferral or installment period for unpaid estate and gift taxes.

c. **Effective Date**. The proposal would apply to 10-year liens already in effect on the date of enactment, as well as to the automatic lien on gifts made and the estates of decedents dying on or after the date of enactment.

d. **Comments**. The change would likely have the IRS formally extend tax liens beyond the 10-year period for any deferred estate tax and in other situations, e.g., for payment of estate tax under Sec. 6161 or 6166. It is not clear whether the IRS extends the period, or whether it may happen automatically by the "new" statute. Also, if the taxpayer extends the statute of limitations period for a gift tax, would the lien automatically continue for such period? Further guidance as to this change will be necessary.

6. Reporting of estimated total value of trust assets and other information about the trust.

a. **Perceived Issue**. Although most domestic trusts are required to file an annual income tax return, there is no requirement to report the nature or value of their assets. As a result, the IRS has no statistical data on the nature or magnitude of wealth held in domestic trusts. Other agencies collect data on the amount of wealth held in some types of domestic trusts, but this data is not comprehensive. Because of the lack of statistical data on the nature and value of assets held in trusts in the United States, it is difficult to develop the administrative and legal structures capable of effectively implementing appropriate tax policies and evaluating compliance with applicable statutes and regulations. This lack of this data further hampers efforts to design tax policies intended to increase the equity and progressivity of the tax system.

b. **Proposal**. The proposal would require certain trusts to report certain information to the IRS on an annual basis to facilitate the appropriate analysis of tax data, the development of appropriate tax policies, and the administration of the tax system. That reporting could be done on the annual income tax return or otherwise, as determined by the Treasury, and would include the name, address, and TIN of each trustee and grantor of the trust, and general information with regard to the nature and estimated total value of the trust's assets as the Secretary may prescribe. Such reporting on asset information might be satisfied by identifying an applicable range of estimated total

value on the trust's income tax return. This reporting requirement for a taxable year would apply to each trust whose estimated total value on the last day of the taxable year exceeds $300,000 (indexed for inflation after 2024) or whose gross income for the taxable year exceeds $10,000 (indexed for inflation after 2024). In addition, each trust (regardless of value or income) would be required to report on its annual income tax return the inclusion ratio of the trust at the time of any trust distribution to a non-skip person, as well as information regarding any trust modification or transaction with another trust that occurred during that year. This additional information will provide the IRS and taxpayers with current information necessary to verify the GST effect of any trust contribution or distribution without requiring either party to go back through multiple prior years' records to determine that information.

c. **Effective Date**. The proposal would apply for taxable years ending after the date of enactment.
d. **Comments**.
    i. This proposal comes from the growing perception that trusts are mechanisms used by wealthy persons to evade taxation or by nefarious characters to pursue criminal or other endeavors. This new reporting would be costly and complex to administer and will come on the heels of the effective date of the Corporate Transparency Act ("CTA") which will itself add burdensome reporting requirements to entities that are ubiquitous in estate planning.[vi] How will privacy be affected by the combination of the trust reporting and the CTA? Certainly, clients will feel as if any privacy they had before the Greenbook and CTA has been compromised.
    ii. With so many trusts owning hard to value property: residences, artwork, family businesses, real estate, etc. any required disclosure of value could be costly. Even if leniency is provided through permitting estimates, on what basis could estimates be obtained without some type of appraisal process?
    iii. Will grantor trusts also be subject to the reporting requirements? What if they don't file a Form 1041? It would seem that if the government goal is to obtain information on trusts that grantor trusts would have to be

included regardless of whether they file income tax returns or not given the tremendous amount of wealth held in grantor trusts. Perhaps revocable trusts will be excluded from the reporting. It is unclear if and, if so, how this would apply to grantor trusts which are not required to file their own income tax returns.

iv. The proposal suggests "identifying an applicable range of estimated total value on the trust's income tax return." What might this mean and what procedures will be necessary? This sounds as if it is suggesting something less than an appraisal which would be quite costly. But consider the implications. In litigation the plaintiff may well get access to the defendant's income tax return, even if portions are redacted in chambers. But consider the implications in a lawsuit or divorce if now almost every trust has a range of values for assets that plaintiff's counsel could access? Consider the implications in matrimonial cases? If a taxpayer is negotiating a prenuptial agreement in the current environment assets in a separate property, pre-marital, trust may not be disclosed or indicated. There are in many cases no estimates of those values to disclose. But now knowing these values are reported annually to the IRS might the dynamic of the non-monied spouse's pre-marital demands change?

v. The threshold for this reporting, $300,000 of net worth for a trust, assures that many trusts created for any substantive estate planning will be affected. The law would cast a wide net. The threshold is far too low considering the cost of compliance and administrative burdens. Perhaps, if this is included in the actual legislation Congress could be convinced to at least limit this to more valuable trusts.

vi. Will the mandated reporting be an extended trust income tax return Form 1041 or will a different reporting mechanism be created with a new or different type of form? That may be relevant as to which professional adviser, CPA or attorney/wealth adviser assumes responsibility for the filings. If on an expanded Form 1041 then likely CPAs will handle the reporting. If it is on a separate form, since some attorneys may well assume

the responsibility of reporting for purposes of the CTA they may handle more of the trust reporting as well. Query whether that would be an advantage since if attorneys gather the information for CTA reporting of entities owned by trusts they may already be in a better position to gather the new information for trust reporting. Whatever occurs, coordination among various professional advisers will likely be necessary.

vii. Reporting the inclusion ratio of the trust for generation skipping transfer ("GST") tax purposes might sound innocuous. Certainly, the stated goal of avoiding having to go back in the future through historical records once the initial reporting is achieved might actually be helpful.

1. But how will the records necessary to corroborate the inclusion ratio be obtained for the initial reporting? For practitioners that did not prepare the initial gift or estate tax return reflecting the trust funding, how will that information be obtained? Many historical records have not been scanned. Many, perhaps most, clients do not keep organized or complete records. So, if the practitioner filing the initial report did not create and assist with the funding of the trust for all years for which transfers were made, how will the GST inclusion ratio be determined?
2. What level of review will be required, or desired, before such a figure can be reported? What will be done when those prior records cannot be obtained? Of course, we have this problem now.
3. What of the law and accounting firms that have merged or closed since the filings were completed?
4. Many GST allocations are made on a formula basis of allocating the minimum amount of GST exemption that is necessary for a trust to have an inclusion ratio of zero. However, many clients have multiple trusts with GST exemption and the formula allocation may provide a rank order of which trusts are allocated GST exemption first. For example, a dynastic trust may be prioritized in the formula to receive GST allocation first and thereafter allocation

may be made to an insurance trust. In such instances the inclusion ratio for the insurance trust may not be known until the statute of limitations on the gift tax return making the tiered formula allocations is resolved and, according to the regulations, when the statute of limitations with respect to the estate tax return of the grantor expires. How will those and other nuances be addressed in the reporting?

viii. What or who will be a trustee for the purposes of the above reporting requirements? Likely a broad definition will be used to make reporting more comprehensive. Thus, "trustee" might be defined as general, investment, distribution and other trustees. What about trust advisers? What about trust protectors? And what does the term "trust protector" even mean given the wide definitions and applications of that concept. Will this be limited to those acting only in a fiduciary capacity? If so, practitioners will have to evaluate the status of each person and role to ascertain whether the person is acting in a fiduciary or non-fiduciary capacity. That may require not only consideration of the trust instrument but of the law in the jurisdiction where the trust has situs.

ix. Apart from the complications of determining who must be listed, consider the information desired. The proposal would require the reporting of the name, address, and TIN of each trustee. If a college roommate agreed to hold a power to loan funds to the settlor, or held a special power of appointment, if those roles are caught within the definitions, how will they feel about their personal information being disclosed to the IRS? The reality is that many of the people named in a variety of roles in different trust instruments never sign the trust document. If, for example, a spousal lifetime access trust ("SLAT") was created and there was no present intent to hold life insurance, a family member or friend might nonetheless be designated as an insurance trustee so that if in the future insurance were to be held the structure would be in place to do so. That "standby" insurance trustee may not have signed the trust instrument and may not recall the

quick phone call or text message from the settlor indicating that they would be appointed. How will their information be obtained to even contact them? How far will all of this go? While a successor trustee would have to agree in writing to serve, the complications and compliance challenges of these new proposals could be significant.

7. Use Of Defined Value Formula Clauses To Determine SIZE OF Bequests Or Gifts.
    a. **Perceived Issue**. Taxpayers often want to make gifts, bequests, or disclaimers in an amount that achieves a particular tax result. For example, a taxpayer may wish to avoid triggering gift tax liability by limiting the gift to that amount of property equal to the donor's remaining gift tax exclusion amount. The mechanism used for such transfers is sometimes referred to a "defined value formula clause." That clause purports to define the gift by a value determined by a formula. Often, the formula determines the value by reference to the results of IRS enforcement activities. An example of such a formula is the following: "I give my interest in [entity] as follows: to my children, that number of units having a fair market value as of [date of gift], as finally determined for Federal transfer tax purposes, of [specified amount] dollars; and to [another person, such as a charity], my remaining number of units after satisfying the gifts to my children." Generally, the units remaining after the defined gift are retained by the owner and other valuation adjustment clauses, and this proposed change gives the IRS its wish on the clauses.
    b. **Proposal**. Curtail the use of formula clauses to adjust the value of bequests or gifts. The clear implication is that those with hard to value assets is that transfer planning should be pursued before the end of 2023 if there is a need for a defined valuation mechanism.
    c. **Effective Date**. The proposal would be effective for gifts made after December 31, 2023.
    d. **Comments.**
        i. It would seem that a King price adjustment to a note, a Wandry mechanism that only transfers the value equal to a specified dollar amount, and a Petter, or Christensen

spill over to a GRAT, QTIP, charity, or incomplete gift trust would all be eliminated.[vii]

ii. The change is broad and massive and would have a chilling effect on any gift or sale transfers after the end of 2023 as the client would have to weigh the potential risk of both gift and GST taxes more carefully in the event of an audit of the transfer of non-marketable property. Perhaps clients might have to weigh the benefit of a transfer to a non-GST exempt trust to avoid imposition of GST as well as gift tax if there is a valuation adjustment at a later audit.

iii. Note that in the explanation of the proposal suggests "Generally, the units remaining after the defined gift are retained by the owner or are given to another person or entity (often a charity or marital trust) whose receipt would not give rise to a gift tax liability." Does that suggest that the concern some commentators had over the use of a spillover to a QTIP trust might be unfounded and that receptacle was valid to use in a defined value mechanism?

iv. Consider the inherent unfairness of the Greenbook elimination of valuation adjustment mechanisms for those whose wealth is concentrated in real estate (that doesn't avoid estate tax via the expanded special valuation rules discussed above) and closely held business interests that are hard to value. In contrast those whose wealth is comprised primarily of marketable securities would not face the uncertainties and potential audit risks of their making similar value transfers. It is not clear why the Administration feels it necessary to discriminate against non-special use valuation assets as compared to other assets.

v. It is common when making transfers to use a two-tier adjustment clause. If, for example, transfers need to be completed quickly and before an appraisal can be obtained, the first tier of a valuation adjustment mechanism might be to adjust the value of the interests transferred to the valuation to be completed after the transfer by an independent appraiser. The second tier of the valuation adjustment mechanism may be to adjust the

interests to gift tax value as finally determined. It appears that the proposal recognizes the viability of this two-tier approach in its providing an exception for the new restrictions for valuation adjustments not pegged to IRS actions, such as a gift tax audit.

vi. The proposal, however, provides that an adjustment based on an independent appraisal has to be one that "occurs within a reasonably short period of time after the date of the transfer." It is not clear what that means but it may restrict the ability to even make an adjustment for an appraisal if that is not done in a short enough period of time after the transfer. That may raise hardships for some clients in situations that have no tax motivation. For example, the client is contemplating getting married and wishes to make a transfer of closely held family business interests immediately so that the transfer is consummated well in advance of the planned marriage. The goal has nothing to do with tax planning but rather to assure that the assets are removed from the client's hands into a trust solution before the wedding so that no fiduciary obligation as to those separate assets may attach as a result of the marriage. The transfer is consummated today and the interest transferred will be adjusted for the value to be determined by an independent named appraisal firm. If that valuation is not completed "within a reasonably short period of time after the date of the transfer," whatever that may mean, the new Greenbook rule may have a negative impact, although it is not clear what that impact might be. Would the Greenbook rule on an adjustment that occurs to far in the future prohibit the adjustment or void the entire transfer?

vii. Some commentators have suggested that incorporation of a GRAT structure might be feasible to provide some continuing protection to a valuation. The GRAT regulations define consideration by formula so that perhaps integration of a GRAT into the planned transfer might somehow provide cover after this proposed change (i.e., even if the GRAT itself is no longer a viable planning tool, might the valuation adjustment mechanism provided in the GRAT Regulations still be able to be harnessed?).

A GRAT with a large remainder interest and which defines the amount reverting to the donor using a formula might be considered. Care will have to be taken even if this is feasible in light of the recent Chief Counsel Advice that attacked a GRAT with a problematic appraisal.[viii]

viii. McCord/Hendrix with arm's length negotiations between the charity and trust doesn't involve the IRS and transferor has nothing to do with that so perhaps that may survive? But what does it mean IRS involved?[ix]

ix. At least one commentator suggested that in these types of structures the IRS is "not involved" as an independent charity and the trust is left to set the value. How that might be interpreted is not clear. It would seem that the intent of the provision is to quash the use of all such defined value mechanisms.

8. Exclusion From The Gift Tax For Annual Gifts.
   a. **Perceived Issue**. The first $17,000 of gifts made to each donee in 2023 are excluded from the donor's taxable gifts (and therefore do not use up any of the donor's lifetime exclusion from gift and estate taxes). This annual gift tax exclusion is indexed for inflation and there is no limit on the number of donees to whom such gifts may be made by a donor in any one year. To qualify for this exclusion, each gift must be of a present interest rather than a future interest in the donated property. A present interest is an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (including life estates and term interests). Generally, a contribution to a trust in the donee is a future interest.
   b. **Proposal**.
      i. The proposal would eliminate the present interest requirement in order for gifts to qualify for the gift tax annual exclusion. Instead, the proposal would define a new category of transfers (without regard to the existence of any withdrawal or put rights) and would impose an annual limit of $50,000 per donor, indexed for inflation after 2024, on the donor's transfers of property within this new category that would qualify for the gift tax annual exclusion.

ii. This new $50,000 limit would not provide an exclusion in addition to the annual per-donee exclusion; rather, it would be a further limit on those amounts that otherwise would qualify for the annual per-donee exclusion. Thus, a donor's transfers in the new category in a single year in excess of a total amount of $50,000 would be taxable, even if the total gifts to each individual donee did not exceed $17,000.

iii. The new category would include transfers in trust (other than to a trust described in section 2642(c)(2)), transfers of interests in passthrough entities, transfers of interests subject to a prohibition on sale, partial interests in property, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee.

c. **Effective Date**. The proposal would be effective for gifts made after December 31, 2023.

d. **Comments**.

i. This is not a new proposal as it has appeared in prior legislative proposals. For most clients it is not going to be an issue, but for some clients it could be a very significant issue.

ii. Consider the client with a robust life insurance plan inside an ILIT who each year makes gifts of large amounts to that trust to cover life insurance premiums. That client's plan will be hampered severely by this change and it may no longer be feasible to continue to fund the insurance premiums or other gift plans. There seem to be several options to address this potential change.

1. Practitioners should identify such clients who have not used all of their exemption and consider whether using exemption to fund gifts to those ILITs, or other transfer plans, before the effective date of the new law may be advisable.
2. Annual exclusion gifts should be given to the maximum extent feasible before year end and the potential restriction becoming effective.
3. There may also be a window to complete GRATs the back-end of which pays to the ILITs to prefund

future premiums which after 2023 would no longer be feasible to fund via annual gifts.

4. If use of exemption gifts, GRATs or perhaps other techniques will not suffice to fund premiums split-dollar life insurance loans may remain one of the few options to maintain the plan. However, consider the changes proposed that will affect split-dollar insurance loans and advances as well.

9. Limit Duration Of Generation-Skipping Transfer Tax Exemption.
    a. **Perceived Issue**.
        i. The generation-skipping transfer (GST) tax is imposed on gifts and bequests by an individual transferor to transferees who are two or more generations younger than the transferor. Each individual has a lifetime GST tax exemption ($12.92 million in 2023) that can be allocated to transfers made by that individual to a grandchild or other "skip person," whether directly or in trust. Allocating GST exemption does not directly exempt any assets or portion of a trust from tax. Rather, allocating GST exemption to a trust or transfer reduces the applicable rate of tax (from as high as 40 percent to as low as 0 percent) on generation-skipping transfers. An allocation of GST exemption to a trust has the potential to exclude from GST tax not only the value to which GST exemption was allocated, but also all subsequent appreciation and accrued income on that value during the existence of the trust.
        ii. In most cases, as long as property remains in a trust, the death of a trust beneficiary typically will not trigger the imposition of estate tax on trust assets. This is because beneficiaries typically have no rights to the trust property that would cause the property to be includable in that beneficiary's gross estate at death. At the termination of the trust, however, the trust assets are required to vest in one or more persons, at which point the assets become the property of those persons and reenter the gift and estate tax base.
        iii. At the time of the enactment of the GST provisions, the laws of most States included a common- law Rule Against Perpetuities (RAP) or some statutory version of it

requiring that every trust terminate no later than 21 years after the death of a person who was alive at the time the trust was created. Today, many States either have limited the application of their RAP statutes (permitting trusts to continue for several hundred or up to 1,000 years), or entirely repealed their RAP statute. In those States, trusts are permitted to continue in perpetuity and the property in those trusts has been permanently removed from the estate and gift tax base.

b. **Proposal**.
   i. The proposal would make the allocation of GST exemption applicable only to: (a) direct skips and taxable distributions to beneficiaries no more than two generations below the transferor [e.g., the transferor's grandchildren], and to younger generation beneficiaries who were alive at the creation of the trust; and (b) taxable terminations occurring while any person described in (a) is a beneficiary of the trust.
   ii. Under current law, section 2653 resets the generation assignment of trust beneficiaries once GST tax has been imposed, treating certain younger generations of skip persons as being in the first generation below that of the transferor (and thus as non-skip persons).
   iii. Under the proposal, section 2653 would not apply in determining the generation assignment of a beneficiary for purposes of testing whether the GST exemption has terminated.
   iv. In addition, solely for purposes of determining the duration of the exemption, a pre-enactment trust would be deemed to have been created on the date of enactment and, in this case, the proposal would provide that the grantor is deemed to be the transferor and in the generation immediately above the oldest generation of trust beneficiaries in existence on the date of enactment.
   v. The result of these proposals is that the benefit of the GST exemption, which shields property from the GST tax, would not necessarily last for a trust's duration. Instead, the GST exemption would only shield the trust assets from GST tax for as long as the life of any trust beneficiary who either is no younger than the transferor's

grandchild or is a of a younger generation who was alive at the creation of the trust (e.g., a great grandchild born before the trust was created.

vi. Specifically, upon the expiration of this limit on the duration of the GST exemption, the trust's inclusion ratio would be increased to one, thereby rendering no remaining part of the trust exempt from GST tax.

vii. Because contributions to a trust from different grantors are deemed to be held in separate trusts under section 2654(b) of the Code, each such separate trust would be subject to the same rule for the duration of the exemption, measured from the date of the first contribution by the grantor of that separate trust. The special rule for pour-over trusts under section 2653(b)(2) would continue to apply to pour-over trusts and to trusts created under a decanting authority, and for purposes of this rule, such trusts would be deemed to have the same date of creation as the initial trust.

viii. The other rules of section 2653 would continue to apply and would be relevant in determining when a taxable distribution or taxable termination occurs. An express grant of regulatory authority to the Secretary and her delegates would be included to facilitate the implementation and administration of this provision.

c. **Effective Date**. The proposal would apply on and after the date of enactment to all trusts subject to the generation-skipping transfer tax, regardless of the trust's inclusion ratio on the date of enactment.

d. **Comments**.

i. Perhaps, a simple way to explain the concept to clients is that the GST exemption will only last as long as people that they know.

ii. These changes would emasculate dynastic planning which has been the focus of much of estate planning for a very long time. It would undermine a key objective of so much of the planning done in recent years using long-term trusts. At first blush it does not appear that there would be a means to circumvent these rules.

iii. For clients seeking to transmit family businesses down the generations at the death of the settlor's grandchildren, a

GST tax would seemingly be due that would wreak havoc on the financial integrity of that business.

iv. If there is no other "out," estate planning will have to focus on providing liquidity at the generational level where GST tax will be due to retain the family business or other illiquid assets, e.g., family homes or compounds, art collections, etc., intact. Perhaps insurance on the lives of the grandchildren upon whose death GST may be triggered may become part of robust insurance plans at very young ages.

v. This change does address what had been thought by many to be the primary purpose of the GST tax, to prevent incredible concentrations of wealth not to raise revenue. This change alone will help move towards that goal. Perhaps, this type of change for social impact may be agreed to on the condition of exemptions remaining high so it is only the super-wealthy who are ever effected by this GST tax.

vi. Will farmers, ranchers and others qualifying for the substantially increased special use valuation rules be permitted to value such property inside a trust with the benefit of that treatment?

vii. Can we craft ways to grant powers of appointment to each generation to soak up their GST exemption and move down a generation the transferor to permit some level of protection for long term trusts? Perhaps granting a trust protector or trustee power to modify or even create powers of appointment and to make distributions if advisable to address these changes in GST may be advisable.

viii. Given that so many trusts were designed to last in perpetuity without assuming any transfer tax impact, how will trust documents need to be revised to contemplate the payment of this large GST tax? Will it be feasible to revise or modify such trusts by non-judicial modification, decanting, or trust protector action? What legal authority will there be for such revisions or modifications? Will the modifications themselves have a tax consequence?

10. Generation-Skipping Transfer (GST) Inclusion Ratio On Transactions With Other Trusts.

a. **Perceived Issue**.
   i. The GST tax is imposed by multiplying the value of a trust by the product of a flat tax rate (equal to the highest estate tax rate, currently 40 percent), and the trust's "inclusion ratio." A trust's inclusion ratio is determined by subtracting the "applicable fraction" from one. Generally, the numerator of the applicable fraction is equal to the amount of GST exemption allocated to the trust and the denominator is equal to the value of the trust. The applicable fraction is redetermined on each allocation of GST exemption to the trust and on certain changes to the trust principal, such as additional contributions to the trust or the consolidation of multiple trusts.
   ii. A popular technique for leveraging the benefit of the GST exemption is for a GST exempt trust to purchase either assets from a GRAT or other trust that is not GST exempt, or a remainder interest in the GRAT or other trust, although this has not been officially "approved" by the IRS. Presumably, a taxpayer engaging in such a sale would treat the transaction as any other reinvestment of trust assets, which would not change the purchasing trust's applicable fraction or inclusion ratio. Because the grantor of the GRAT cannot effectively allocate GST exemption to the GRAT until the end of the GRAT is not exempt from GST tax at the time of such a purchase, but the purchase by the GST exempt trust, in effect, cleanses the purchased interest of its GST potential. Therefore, a purchase of the remainder interest shortly after the creation of the GRAT could significantly leverage the taxpayer's GST exemption by avoiding the need to allocate GST exemption at the end of the GRAT term to shield the purchased property from GST tax although again the IRS has not approved such a strategy. While it appears that the categories of the changes to trust principal that trigger a redetermination of a trust's inclusion ratio could be expanded by regulations, it is not clear that regulations could adequately address the effect of sales between trusts.
b. **Proposal**.

i. The proposal would treat a trust's purchase of assets from, or interests in, a trust that is subject to GST tax (regardless of the selling trust's inclusion ratio), as well as a purchase of any other property that is subject to GST tax, as a change in trust principal that would require the redetermination of the purchasing trust's inclusion ratio when those assets (or trust interest) are purchased.

ii. Specifically, the inclusion ratio would be redetermined in the same way as in the case of a consolidation of trusts: the purchased assets would be included in the total value of the trust in the denominator of the applicable fraction, and only the portion of those assets excluded from GST tax immediately before the purchase would be added into the numerator of the fraction.

iii. The proposal similarly would apply to a trust's receipt of assets pursuant to a decanting of another trust (generally, the distribution of trust property to another trust pursuant to the trustee's discretionary authority to make distributions to, or for the benefit of, one or more beneficiaries of another trust).

c. **Effective Date.** The proposal would apply to all such transactions occurring after the date of enactment.

d. **Comments**.

i. Will this change apply to a trust that is GST exempt with a shorter rule against perpetuities, e.g., the common law lives in being plus 21 years to a trust that is GST exempt but formed in a state with 1,000-year rule against perpetuities? Will this even matter with the other changes proposed?

ii. The proposal ignores the existence of the debt or note typically owed back to the selling non-GST exempt trust in valuing assets. Query whether leveraging the asset sold to a zero value (e.g., an LLC held in a non-exempt trust worth $100 million would leverage itself before it is sold) so that asset value sold is nominal or zero would change the result.

iii. Does this proposal suggest that the application of this technique before enactment was valid?

11. GST Tax Characterization Of Certain Tax-Exempt Organizations.

a. **Perceived Issue**.
   i. A taxable termination is one of three types of transfers that trigger the imposition of GST tax. In defining a taxable termination of a trust, the statute provides that there is no taxable termination as long as a non-skip person has an interest in the trust. Although for this purpose, the current GST statute ignores trust interests held by most charities, there are other types of non-charitable tax-exempt organizations that are treated as non-skip persons. As a result of this characterization, a discretionary interest held by such an organization will prevent a taxable termination and thereby avoid the imposition of GST tax. [x]
   ii. Because many types of tax-exempt organizations are included in the definition of a non-skip person with an interest in the trust for purposes of determining taxable terminations, simply naming one of these organizations (other than most charities) as a potential recipient of trust distributions is enough to avoid the imposition of GST tax on the trust, even though that organization may be unlikely to ever receive a distribution from the trust. In this way, the statute has created a loophole being used by taxpayers to avoid GST tax.

b. **Proposal**. The proposal would ignore trust interests held by additional tax-exempt organizations for purposes of the GST tax. As a result, the inclusion of such an organization as a permissible distributee of a trust would not prevent the occurrence of a taxable termination subject to GST tax.

c. **Effective Date**. The proposal would apply in all taxable years beginning after the date of enactment.

d. **Comments**.
   i. Since the rule appears to apply after date of enactment might a GST triggering event occur on the date of enactment for those trusts that will no longer have a valid non-skip person as beneficiary.
   ii. Does this proposal suggest that the application of this technique before enactment was valid?

12. Tax Rules For Grantor Trusts.

a. **Perceived Issue**.
   i. Generally, a trust is a grantor trust, and the grantor is its deemed owner, if the grantor (a) creates a revocable

trust, or (b) creates an irrevocable, and, among other situations, retains certain powers over the trust or its assets (such as the power to control or direct the trust's income or assets). A deemed owner of a grantor trust is treated as owning the assets of the trust solely for income tax purposes.[xi] As a result, sales and other transactions between a grantor trust and its deemed owner are disregarded for income tax purposes so no income tax on gains is incurred. Further, the income tax liability generated by a trust's assets is the obligation of the deemed owner, rather than the obligation of the trust or its beneficiaries. No amount paid by the deemed owner of a grantor trust to satisfy the trust's income tax liability is treated as a gift by the deemed owner to the trust or its beneficiaries for Federal gift tax purposes.[xii]

ii. A grantor retained annuity trust (GRAT) is an irrevocable grantor trust in which the grantor retains an annuity interest for a term-of-years. At the end of that term, the assets then remaining in the trust are transferred to (or held in further trust for) the beneficiaries. The gift of this remainder interest is subject to gift tax at the creation of the trust and is valued by deducting the present value of the grantor's retained annuity interest from the fair market value of the property contributed to the GRAT. The present value of the grantor's retained annuity interest is the value of the expected payments to the grantor during the GRAT term, determined using a discount rate or rate of return based in part on the applicable Federal rate in effect for the month in which the GRAT is funded.

iii. GRATs and grantor trusts allow taxpayers to substantially reduce their combined Federal income, gift, and estate tax obligations through tax planning. The proposal addresses the three most common and significant planning techniques that allow the grantor to remove significant value from the taxpayer's gross estate for Federal estate tax purposes without Federal income or gift tax consequences. It is perceived that reform is needed to close the existing loopholes and ensure the effective operation of the Federal income, gift, and estate taxes. To be effective, any change in the law should

address all of these techniques; otherwise, taxpayers will simply shift their planning from one technique to the other.

iv. The first technique is the funding of a GRAT with assets that are expected to appreciate. If the value of a GRAT's assets appreciate at a rate that exceeds the relatively low statutory interest rate used to value the grantor's retained annuity interest, that excess appreciation will have been transferred to the remainder beneficiaries with little or no gift tax. Because almost the entire value of the GRAT assets generally is includible in the grantor's gross estate for Federal estate tax purposes if the grantor dies during the GRAT term, the grantor usually selects a GRAT term that the grantor expects to survive. To minimize the gift tax cost, the GRAT is structured to have a remainder interest with only a very small value and thus incurring very little gift tax. As a result, even if the GRAT assets do not significantly appreciate by the end of the GRAT term, the GRAT involved little to no cost or downside risk for the grantor.

v. The second technique is the sale of an appreciating asset to a grantor trust by its deemed owner. Generally, when a taxpayer sells an appreciating asset to a grantor trust of which the taxpayer is the deemed owner for income tax purposes, the sale is disregarded for income tax purposes. Such a sale allows the taxpayer to remove the future appreciation (above the hurdle rate that must be paid as interest to the grantor) from the taxpayer's gross estate without the payment of gift or estate tax and without the recognition of any capital gain on the sale.

vi. The third technique is the deemed owner's repurchase of an appreciated asset from the grantor trust for the asset's then-fair market value, usually shortly before the deemed owner's death.

vii. Generally, as with the grantor's sale of an appreciating asset to the trust, when a grantor trust sells an appreciated asset back to the trust's deemed owner, the purchase is disregarded for income tax purposes, so no capital gains tax is incurred. When the deemed owner dies, the appreciated asset is part of the grantor's gross estate, so its basis is adjusted (usually increased) to its

fair market value on the date of death. In this way, no gain is ever taxed, and the trust has the same value as immediately before the repurchase by the deemed owner but without the future capital gains tax liability on the appreciation that accrued before the deemed owner's death.

viii. Finally, because the deemed owner's payment of the income tax on the trust's taxable income and gains each year is considered the owner's payment of their own tax liability and therefore is not a taxable gift, the property in the grantor trust can grow free of income tax, without any gift tax cost.

b. **Proposal**.

i. The proposal would require that:

1. the remainder interest in a GRAT at the time the interest is created have a minimum value for gift tax purposes equal to the greater of 25 percent of the value of the assets transferred to the GRAT, or $500,000 (but not more than the value of the assets transferred).
2. In addition, the proposal would prohibit any decrease in the annuity during the GRAT term,
3. And it would prohibit the grantor from acquiring in an exchange an asset held in the trust without recognizing gain or loss for income tax purposes.
4. Finally, the proposal would require that a GRAT have a minimum term of ten years and a maximum term of the life expectancy of the annuitant plus ten years.
5. These provisions would impose some downside risk on the use of GRATs so they are less likely to be used purely for tax avoidance purposes (although it is somewhat difficult to determine why they otherwise would be used).

ii. For trusts that are not fully revocable by the deemed owner, the proposal would treat the transfer of an asset for consideration between a grantor trust and its deemed owner or any other person as one that is regarded for income tax purposes, which would result in the seller recognizing gain on any appreciation in the transferred

asset and the basis of the transferred asset in the hands of the buyer being the value of the asset at the time of the transfer. Such regarded transfers would include sales as well as the satisfaction of an obligation (such as an annuity or unitrust payment) with appreciated property. However, securitization transactions would not be subject to this new provision. (A corresponding addition to disallowed losses would be made to section 267(b) of the Code).

iii. The proposal also would provide that the payment of the income tax on the income of a grantor trust (other than a trust that is fully revocable by the grantor) is a gift. That gift is to occur on December 31 of the year in which the income tax is paid (or, if earlier, immediately before the owner's death, or on the owner's renunciation of any reimbursement right for that year) unless the deemed owner is reimbursed by the trust during that same year. The amount of the gift is the unreimbursed amount of the income tax paid. The amount of the gift cannot be reduced by a marital or charitable deduction or by the exclusion for present interest gifts or gifts made for the donee's tuition or medical care. The gift, however, is an adjusted taxable gift.

iv. **Effective Date**.

1. The GRAT portion of the proposal would apply to all trusts created on or after the date of enactment.
2. The portion of the proposal characterizing the grantor's payment of income taxes as a gift also would apply to all trusts created on or after the date of enactment.
3. The gain recognition portion of the proposal would apply to all transactions between a grantor trust and its deemed owner or any other person occurring on or after the date of enactment. It is expected that the legislative language providing for such an immediate effective date would appropriately detail the particular types of transactions to which the new rule does not apply.

c. **Comments**.

i. GRATs.

1. New GRATs will probably not be practical, certainly in their traditional estate transfer application after enactment. What might that mean? Well, “Get It While You Can,” was not only a great album by Janis Joplin, but the GRAT motto on the advice practitioners might give to clients now.
2. Want to do a 99-year GRAT? Get It While You Can.
3. Used up all your exemption and want to make transfers using GRATs? THEN, Get It While You Can. Perhaps, AN approach might be to create a series of GRATs of different terms to minimize the mortality risks of the plan (e.g., if life expectancy is 10 years perhaps create a ladder of GRATs consisting of a 6, 8-, 10-, 12- and 14-year GRATs) rather than just a 2-year GRAT based on the assumption of rolling or cascading the GRAT into new 2 year GRATs when each matures, because after the date of enactment that won’t be feasible.
4. For existing GRATs, e.g., the ladder of GRATs suggested above, after enactment payment of an annuity in-kind will trigger gain. Explore alternatives to funding for the next GRAT payment realizing that an annuity payment cannot be paid with a note. Financing from a related family entity or trust, or even a third-party lender, may be worth starting to line up in advance of a large payment due.[xiii]

ii. Tax reimbursements.

1. Payment of income taxes on any grantor trust created on or after the date of enactment will constitute a gift. So, Get It While You Can. Set up grantor trusts now, before date of enactment to grandfather those trusts before enactment so that this issue, which could be economically catastrophic to any post-enactment grantor trust. Many clients already have grantor trusts in place from the planning done generally, or for 2012, 2020-2021 planning. Clients and prospective clients that have not yet created grantor trusts, perhaps that should be done now accelerating the steps for pre-2026 use of exemption. And in the context of creating

trust planning now, the discussions many commentators have had about spreading planning out over several years prior to 2026 may be passe. Perhaps, the worries about step-transaction and reciprocal trust issues may have to give way to concerns about portions of the Greenbook being enacted as part of the debt ceiling negotiations. maybe, the safest way for practitioners to handle this is to explain the pros/cons/options to a client and then let the client make the decision as to which risk they want to accept and which risk they want to avoid. The client should decide whether to accelerate planning to, perhaps, beat the above date of enactment rule, and to maybe accept greater step-transaction and/or reciprocal trust doctrine risks. If the client makes that decision, the practitioner should then be responsible for the consequences if the bet loses. Practitioners should not get in between these estate planning versions of Scylla and Charybdis.

2. Might it be feasible to make retroactive tax reimbursements repaying the grantor for prior year's income taxes using appreciated property before date of enactment?

iii. The provision triggering gain recognition on transactions between a grantor trust and its deemed owner or after the date of enactment would put a chilling effect on many current planning techniques and transactions.

1. Income tax free swaps with grantor trusts will no longer be possible. Practitioners might caution clients that if they want a trust asset back in their name for basis step up or to provide for an alternative disposition scheme then the trust provides for, perhaps that swap should be completed before date of enactment (and when is that?).
2. GRATs will not be able to use appreciated assets to make annuity payments income tax free. Might it be advantageous if assets are required to pay an annuity to set up lines of credit or loan

arrangements as noted above? Might it be advantageous to swap certain appreciated assets out of a GRAT prior to the effective date of any such legislation for non-appreciated assets?

3. Note income tax free sales to grantor trusts won't be permitted after enactment although one might still do such sales unless there amount of tolerable gain that will be recognized if tolerable. But highly appreciated assets won't be useable to repay notes in the future as that will trigger gain. So, perhaps, some portion or all of the notes a grantor received on a note sale transaction should be repaid before enactment to avoid the issue in the future.
4. This proposal may influence how a Wandry valuation adjustment mechanism is structured pre-enactment since it may in the future not be feasible to then transfer the interests that remain in the donor's estate under a Wandry clause. This is similar to the response some used to address the expansive view of Code Sec. 2036(a)(2) under Powell/Cahill. [xiv]
5. Some consideration might be given to not using a traditional Wandry adjustment mechanism and use a different approach to assure that no equity remains with the transferor in order to assure that the transferor cannot "in conjunction with" control any of the entity interests transferred. Consider a secondary sale of any interests remaining with the seller as a result of the Wandry clause effective on the date of the primary sale at a price pegged at the gift tax value as finally determined. Consider signing a secondary purchase agreement at the date of the initial transfer and effective as of that date to govern this. The issue of this approach in the context of planning for the Greenbook proposal is will the secondary sale be respected as occurring on the date of the initial transfer or will that be tagged as occurring somehow after the date of enactment and thus trigger gain?

13. Definition Of A Guaranteed Annuity From A Charitable Lead Annuity Trust (CLAT).

a. **Perceived Issue**.

i. A CLAT requires the payment of an annuity at least annually to one or more charitable beneficiaries for a term of years or for the life of the donor. At the end of that term, the trust distributes any remaining trust property to OR FOR noncharitable remainder beneficiaries. The CLAT's grantor makes a gift of the remainder interest to the remainder beneficiaries on the creation of the CLAT, and the present value of that deferred remainder interest is based, in part, on The IRS assumed rate of growth for the trust's assets during the annuity term. However, the actual rate of appreciation of the trust's assets can exceed the assumed rate of growth on which the gift tax calculation is based. As a result, the value of the remainder interest subjected to gift tax on the CLAT's creation can be significantly less than the value of the remainder interest received by the noncharitable beneficiaries at the end of the CLAT term.

ii. The term of a CLAT and the size of the annual annuity generally are structured to cause the deferred value of the remainder interest for transfer tax purposes to be minimal or zero even though the actual value of that remainder interest is expected to be substantial. The longer that amounts of annuity payments to the charity can be delayed, the longer the trust assets can remain in the trust where the expectation is that they will continue to appreciate in value. On the other hand, a higher annuity amount payable from the beginning of the trust term can reduce the appreciation that otherwise would accrue for the ultimate benefit of the remaindermen. As a result, taxpayers often design the CLAT to have an annuity that increases over the trust term, thereby largely deferring the charitable benefit until the end of the trust term. This technique can exponentially increase the value of the remainder without gift tax consequences.

b. **Proposal**. The proposal would require that the annuity payments made to charitable beneficiaries of a CLAT at least annually must be a level, fixed amount over the term of the

CLAT, and that the value of the remainder interest at the creation of the CLAT must be at least 10 percent of the value of the property used to fund the CLAT, thereby ensuring a taxable gift on creation of the CLAT.

c. **Effective Date**. The proposal would apply to all CLATs created after the date of enactment.

d. **Comments**. While it was obvious that the IRS did not like so-called Shark-Fin CLATs where in the payments in all years were modest with a large balloon payment in the final year. The graphic image of this would be a line of modest height for all years of the CLAT with a spike in the final year that supposedly appeared to be like of fin of a shark, hence the name. The mathematics of a shark-fin CLAT favored the success of the wealth transfer as more of the CLAT assets remained in the trust as long as feasible to enhance the growth outside the estate. The proposal, however, does not merely eliminate the Shark-Fin CLAT but any CLAT with other one providing for level payments. The combination of modifications will make CLATs far less appealing and will not only eliminate the use of Shark-Fin CLATs but will serve as a damper on most uses of CLATs.

14. Tax Treatment Of Loans From A Trust.

a. **Perceived Issue**.

i. The Internal Revenue Code (Code) has complex and comprehensive rules governing the income, GST, and sometimes gift tax consequences of distributions from trusts to trust beneficiaries. Generally, these rules are intended, at least in part, to ensure that those who enjoy the benefits from a trust share an appropriate level of tax liability related to the receipt of those benefits. However, except for certain loans from a foreign trust to a U.S. person, a loan from a trust does not carry with it any tax consequences to the borrower.

ii. Loans to trust beneficiaries are being used to avoid the income and GST tax consequences of trust distributions. The current widespread practice of making loans rather than distributions from dynastic trusts subject to the GST tax supports the conclusion that loans are an alternative method of obtaining beneficial enjoyment from a trust. Although a loan differs from a distribution because of the

obligation to repay, the borrower nevertheless is receiving property from the trust – a benefit that the borrower is unlikely to have been able to otherwise obtain. In addition, these loans often are forgiven or otherwise remain unpaid, and it is difficult for the IRS to identify those occurrences and thus to collect the taxes that should be paid in such circumstances. Thus, the use of loans allows taxpayers to divorce their ability to benefit from trust assets from the receipt of income for tax purposes, which allows them to inappropriately avoid income and GST taxes. In addition, treating loans as distributions would facilitate tax administration and compliance by providing the IRS with greater visibility into transactions with trusts and information about who is benefiting from a trust.

b. **Proposal**.
   i. The proposal would treat loans made by a trust to a trust beneficiary as a distribution for income tax purposes, carrying out each loan's appropriate portion of distributable net income to the borrowing beneficiary. In addition, a loan to a trust beneficiary would be treated as a distribution for GST tax purposes, thus constituting either a direct skip or taxable distribution, depending upon the generation assignment of the borrowing beneficiary.
   ii. Within one year after the final payment made on the loan to the trust (whether or not that constitutes full satisfaction of the loan), a refund of the appropriate amount of GST tax (with interest only from the date of the claim for refund) could be requested to be refunded to the payor of the GST tax that was incurred when the loan was made.
   iii. To discourage borrowing from a trust by a person who is not a trust beneficiary but who is a deemed owner of the trust under the grantor trust rules, the proposal would create a special rule for GST tax purposes. Specifically, the repayment (regardless of the identity of the payor) of any loan made by a trust to a deemed owner or the spouse of a deemed owner would be treated as a new contribution to the trust by the borrowing deemed owner(s). Depending on the generation assignments of the trust's beneficiaries at the time of the repayment, this new contribution (like any other contribution) would utilize

GST exemption of the borrower(s), generate a GST tax liability in the case of a direct skip on such borrower(s) or their respective estates, or increase the trust's inclusion ratio. Any GST tax payable on such a deemed direct skip that could not be collected from a deemed owner or a deceased deemed owner's estate (such as, if the time for collecting such a debt from a decedent has expired), would be payable by the trust itself.

iv. The proposal includes a grant of regulatory authority to identify certain types of loans that would be excepted from the application of the proposal. This authority could be used to exempt short- term loans, which do not raise the same concerns. Similarly, another exception might be the use of real or tangible property for a minimal number of days.

c. **Effective Date**. The proposal would apply to loans made, as well as to existing loans renegotiated or renewed by trusts after the year of enactment.

d. **Comments**.

i. Treating a loan as distributing out distributable net income ("DNI") from a trust will force trust borrowers to report income on the funds borrowed. The stated purpose of this provision is somewhat unclear as if a trust loans money to a beneficiary the trust would under current law retain any income and pay tax at higher or compressed trust income tax rates. Trusts reach the maximum income tax bracket at a mere $14,000 of trust income whereas a married individual would not reach the maximum income tax bracket until about $600,000. Thus, mandating that loans carry out DNI in addition to distributions would seem to lower the income tax realized on the income involved to the detriment of the IRS. Is the purpose of this proposal being the additional information to be cleaned by the IRS not the tax revenue?

ii. This provision undermines the historic treatment of valid loans. So, the validity of a loan will no longer be respected no matter how carefully handled.

iii. What is the impact of the economics of this? If a beneficairy needs $100,000, a loan of $100,000 would no longer suffice so that the amount transferred would have to be

grossed-up by the tax cost to provide the desired economic benefit.

iv. Once a loan is paid out and draws out income it would have to still be repaid if it were a loan so that it may be more beneficial for the recipient to pay out a distribution so that the net of income tax cost would be the same but without the requirement to repay the funds.

v. How will trustees address this? For example, if there are three beneficiaries of a trust and there is a need to make a payment to one, it may have been common to structure that transfer as a loan so that it would have to be repaid to preserve the ultimate equality of benefits to all three beneficiaries. This was not done for tax benefits but for economic and fairness reasons. Now, that same transaction will be fare more complicated as a result of these tax implications.

vi. What will the terms of the trust provide for? Will a trustee have the latitude to gross up a “loan” transfer for the new tax costs?

vii. What if any implication will there be on state income taxation. If the above analysis is correct the federal income tax implications may actually be favorable. But if a loan is treated as carrying out DNI to a beneficairy will that now trigger state income tax that would not have otherwise been recognized? Because under the income tax laws of virtually all states, the state income tax consequences would seem to follow the federal consequences. Perhaps. For example, a trust has situs in a no-tax jurisdiction, had the trust retained the income as it would have even made a loan under current law, no state income tax would be due on that income. However, if the federal tax proposal treats a loan as carrying out DNI a “loan” to a beneficiary in a high tax state that bases taxation on federal DNI will not create a state income tax that would not exist under current law. Worse, under state tax regimes, e.g., California, that one “loan” that now carries out DNI might change the classification of that beneficiary from a contingent beneficiary to a current beneficiary with significant and negative state income tax consequences to the trust’s taxation.

15. Valuation Of Promissory Notes.

a. **Perceived Issue**.

i. Generally, an individual who lends money at a below-market rate of interest to another individual is treated as making a gift for gift tax purposes and the lender is imputed a commensurate amount of income for Federal income tax purposes. The Internal Revenue Code (Code) requires minimum rates of interest based on the duration of a note or other loan (its term) to avoid imputed gift and income tax consequences. The IRS issues monthly rates for each term. These rates effectively create a safe harbor: if the interest rate on a loan is at least equal to the minimum rate of interest specified by the IRS for a loan of the same term, the loan avoids being a "below-market loan" (the forgone interest on which is subject to income tax) and the loan is not treated as a gift for gift tax purposes.

ii. The rules for below-market loans allow taxpayers to take inconsistent positions regarding the valuation of loans to achieve tax savings. Typically, a taxpayer sells a valuable asset within their family for a promissory note carrying the minimum interest rate required to ensure that the loan is not taxed as a below-market loan for Federal income tax purposes. The taxpayer claims that the minimum interest rate is sufficient to avoid both the treatment of any foregone interest on the loan as imputed income to the lender and the treatment of any part of the transaction as a gift.

iii. However, in subsequently valuing that unpaid note for Federal gift tax or Federal estate tax purposes after the death of the taxpayer, the taxpayer or the estate takes the position that the fair market value of the note should be discounted because the interest rate is well below the market rate at the time of the taxpayer's death. In other words, the taxpayer relies on the statutory rules to assert that the loan is not below market for gift tax purposes at the time of the transaction but relies on the underlying economic characteristics later to assert the loan is below market for later gift tax or for estate tax purposes.

iv. Alternatively, the term of a promissory note may be very lengthy, and at death, the holder's estate may claim a significant discount on the value of the unpaid note based on the amount of time before the note will be paid in full.

b. **Proposal**.
   i. The proposal would impose a consistency requirement by providing that, if a taxpayer treats any promissory note as having a sufficient rate of interest to avoid the treatment of any foregone interest on the loan as income or any part of the transaction as a gift, that note subsequently must be valued for Federal gift and estate tax purposes by limiting the discount rate to no more than the greater of the actual rate of interest of the note, or the applicable minimum interest rate for the remaining term of the note on the date of death. The Secretary and her delegates (Secretary) would be granted regulatory authority to establish exceptions to account for any difference between the applicable minimum interest rate at the issuance of the note and actual interest rate of the note.
   ii. In addition, the term of any note (regardless of its rate of interest) would be shortened for purposes of valuing that note if there is a reasonable likelihood that the note will be satisfied sooner than the specified payment date and in other situations as determined by the Secretary.

c. **Effective Date**. The proposal would apply to valuations as of a valuation date on or after the date of enactment.

d. **Comments**.
   i. The IRS has long argued that valuing notes that were treated at face for a note sale transaction to a grantor trust, or other planning application, at a discount, was inconsistent with the position the taxpayer took on the notes issuance. That position has economic merit and the stated goal of this change is to have notes valued consistently. While that may be reasonable the question is how broad the application of this will be. Would a change in the economic position of the borrower change the value or would the note still have to be valued consistently?
   ii. If the myriad of other harsh restrictions are enacted note sales of appreciated property, perhaps a primary catalyst

for the creation of intra-family notes, will decline precipitously if not disappear. Thus, there will be far fewer new notes to be subjected to any rule.

iii. The right of the IRS to shorten the term of a note for valuation purposes "if there is a reasonable likelihood that the note will be satisfied sooner" is clearly targeted at eliminating the split dollar loan transactions designed to substantially reduce the value in the lender's estate for estate tax purposes similar to what was done in the Levine case.[xv] But in that case the transaction was not a loan but an advance under the split-dollar regulations. Will the proposal be extended to apply to non-loan economic benefit advances as well?

iv. How broadly and narrowly will "if there is a reasonable likelihood that the note will be satisfied sooner" be applied? The proposal is so vague that it would seem the IRS might have an argument to apply this to any loan transaction. If the rates of interests have declined since the note was issued such that the taxpayer would be inclined to renegotiate the loan to a lower rate, a common transaction, would that mere change in rate have the IRS argue that the loan term should be deemed close to zero?

16. The Value Of Transferred Property For Transfer Tax Purposes.

a. **Perceived Issue**.

i. The standard for determining the value of transferred property for transfer tax purposes is fair market value ("FMV"), which is defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all relevant facts. In determining the FMV of various forms of partial interests, appraisers generally consider several factors, such as the form of ownership, restrictions on transferability, and prevailing market conditions. These factors can increase the value of a transferred interest (in the form of a premium) or decrease the interest's value by applying valuation discounts for things like lack of marketability and lack of control.

ii. The Code disregards the effects on FMV of liquidation restrictions on controlled partnerships and corporations in

limited circumstances but does not modify the FMV of partial interests in assets.

iii. The valuation of partial interests in closely held entities, real estate and other personal property offers opportunities for tax avoidance when those interests are transferred intrafamily. Taxpayers regularly transfer portfolios of marketable securities and other liquid assets into partnerships or other entities, make intrafamily transfers of interests in those entities (instead of transferring the liquid assets themselves), and then claim entity-level discounts in valuing the gift. Similarly, taxpayers often make intrafamily transfers of partial interests in other hard-to-value assets such as real estate, art, or intangibles, allowing all family co-owners to claim fractional interest discounts.

iv. While valuation discounts for lack of marketability and lack of control are factors properly considered in determining the FMV of such interests in general, they are perceived as not appropriate when families are acting in concert to maximize their economic benefits. In these cases, because the family often ignores the restrictions that justified the discounts, the claimed FMV of the transferred interest is below its real economic value, artificially reducing the amount of transfer tax due.

b. **Proposal**.

i. The proposal would replace section 2704(b) of the Code, which disregards the effect of liquidation restrictions on FMV, and instead provide that the value of a partial interest in non- publicly traded property (real or personal, tangible or intangible) transferred to or for the benefit of a family member of the transferor would be the interest's pro-rata share of the collective FMV of all interests in that property held by the transferor and the transferor's family members, with that collective FMV being determined as if held by a sole individual. Family members for this purpose would include the transferor, the transferor's ancestors and descendants, and the spouse of each described individual.

ii. In applying this rule to an interest in a trade or business, passive assets would be segregated and valued as

separate from the trade or business. Thus, the FMV of the family's collective interest would be the sum of the FMV of the interest allocable to a trade or business (not including its passive assets), and the FMV of the passive assets allocable to the family's collective interest determined as if the passive assets were held directly by a sole individual. Passive assets are assets not actively used in the conduct of the trade or business, and thus would not be discounted as part of the interest in the trade or business.

iii. This valuation rule would apply only to intrafamily transfers of partial interests in property in which the family collectively has an interest of at least 25 percent of the whole.

iv. An attribution rule, that would be relevant only for purposes of determining whether the family's collective interest meets that threshold, would attribute to a person the maximum interest held through an entity or trust that could be allocated to that person. However, for purposes of determining the FMV of the family's collective interest, only interests held directly by a member of the family, inter ests held through a general partnership or wholly owned entity, and interests held in trusts either for the sole benefit of the family member or that are withdrawable or fully revocable by the family member, would be taken into consideration.

c. **Effective Date**. The proposal would apply to valuations as of a valuation date on or after the date of enactment.

d. **Comments**.

i. The obvious goal of this is to eliminate certain valuation discounts. But how will:
"transferred to or for the benefit of a family member of the transferor" be defined? It would seem that certainly a trust for the benefit of the transferor's descendants would apply but what about a trust for the transferor's descendants and charity? What about a trust that also names one or more elderly relatives that are outside of the statute's definition of "family?"

ii. How will "transferred to or for" be defined? What if there is no transfer and various family members and trusts

purchase fractional interests in a new asset? In that case there is no transfer.

iii. How will "family member" be defined for these purposes? The proposal states: "Family members for this purpose would include the transferor, the transferor's ancestors and descendants, and the spouse of each described individual." With the evolution of the modern "family" "there is no longer one dominant family form in the U.S."[xvi] There may still be opportunities to plan for variations of traditional family units where the rules may not technically apply to the relationships of a particular client.

iv. The requirement to separate passive assets will raise significant complexity. That concept has been included in previous proposals. "passive assets would be segregated and valued as separate from the trade or business." Is cash or working capital in a business still passive? What about funds held in reserve to replace a roof on a building? Will these types of distinctions matter? If so, then similar to decades ago when it was common to create annual minutes and corroborate the business purpose of liquid assets held in corporate solution to avoid an accumulated earnings tax, similar issues may have to be addressed now.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Martin M. Shenkman

Jonathan G. Blattmachr

Joy Matak

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[i] IRB: 2023-16, dated April 17, 2023.

[ii] https://theconversation.com/68-of-americans-do-not-have-a-will-137686.

[iii] https://www.fool.com/investing/general/2015/07/22/8-ways-to-avoid-a-nanny-tax-nightmare.aspx#:~:text=Most%20people%20don't%2C%20and,run%20afoul%20of%20the%20IRS.

[iv] . https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/farming-and-farm-income/#:~:text=In%20the%20most%20recent%20survey,recorded%20in%20the%20early%201970s.

[v] . https://www.fb.org/market-intel/farm-inputs-u-s-agricultural-land-values-show-record-increase#:~:text=Like%20overall%20agricultural%20real%20estate,2005%20when%20rates%20jumped%2018%25.

[vi] https://www.fincen.gov/boi#:~:text=The%20Corporate%20Transparency%20Act%20%28CTA%29%20establishes%20uniform%20beneficial,registered%20to%20do%20business%20in%20the%20United%20States.

[vii] King v. United States, 545 F.2d 700 (10th Cir. 1976); Wandry v. Commr. of Internal Revenue, T.C. Memo. 2012-88 (March 26, 2012); Petter v. Commissioner, T.C. Memo. 2009-280; Christiansen v. Commissioner, 130 T.C. 1 (2008), aff'd, 586 F.3d 1061 (8th Cir. 2009).

[viii] CCA 202152018.

[ix] Succession of McCord, 461 F.3d 614 (5th Cir. 2006), rev'g 120 T.C. 358 (2003); Hendrix, T.C. Memo. 2011-133.

[x] The footnote in the Greenbook provides: Specifically, the proposal would treat an organization described in section 501(c)(4) through (29) other than (c)(10) for GST tax purposes in the same way as an organization described in section 2055(a).

[xi] See Rev. Rul. 85-13, 1985-1 CB 184.

[xii] Rev. Rul. 2004-64, IRB 2004-27.

[xiii] For a more detailed discussion of planning concepts that might apply see Shenkman and Blattmachr, "Using Grantor Retained Annuity Trusts In The Current Environment," ActionLine (FL Bar), pg. 38, Summer 2020.

[xiv] Estate of Nancy H. Powell v. Commissioner, 148 T.C. No. 18 (2017); Estate of Cahill, T.C. Memo. 2018-84.

[xv] Estate of Marion Levine v. Commr,. 158 T.C. -- No. 2, February 28, 2022.

[xvi] https://www.pewresearch.org/social-trends/2015/12/17/1-the-american-family-today/ .