

Estate Planning Tax Update—Highlights of Current Developments



Steve R. Akers and Ronald D. Aucutt, Bessemer Trust

[Page numbers in square brackets refer to the “Estate Planning Current Developments and Hot Topics” (August 2022) (EP) and the “Washington Update: Pending and Potential Administrative and Legislative Changes (With Selected Cases)” (August 2022) (WU).]

1. Legislative Proposals

- a. FY 2023 Greenbook; Administration Priorities [EP2-8, WU21-30]
 - (1) Business Tax Provisions – Increase corporate rate from 21% to 28%, reduce basis shifting by related parties through partnerships [EP2]
 - (2) Income Tax for High-Income Taxpayers – Increase top rate from 37% to 39.6% for taxpayers with taxable income over \$450,000 (joint returns), tax capital gains at ordinary rates for taxpayers with taxable income over \$1 million (\$500,000 for married individuals filing separate returns), treat transfers of appreciated property by gift or on death as realization events, mark-to-market annual taxation of income from tradeable property for taxpayers having either \$100 million of income or \$1 billion of “applicable assets” [EP2-4, WU21-25]
 - (3) Estate and Gift Proposals [EP5-8, WU25-30]
 - (a) GRATS (10-year minimum term, 25% remainder interest, maximum term of life expectancy plus 10 years, no decrease in annuity during GRAT term, prohibition of grantor acquiring GRAT assets in a nonrecognition transaction)
 - (b) Grantor Trusts (recognition of gain on sales transactions with grantor trusts, treating payment of income tax by deemed owner of grantor trust as a gift)
 - (c) Consistent Valuation of Notes
 - (d) Limited Duration of GST Exemption
 - (e) Miscellaneous Other Provisions
 - (f) Not Included – reduction of exclusion amount prior to 2026, inclusion of grantor trust assets in gross estate, look-through valuation rules for nonbusiness assets in entities
 - (4) Selected Miscellaneous Provisions – taxing “carried interests” as ordinary income, eliminating like-kind exchanges for gains over \$500,000 (\$1 million for joint returns), limiting use of donor advised funds to avoid private foundation annual payout requirement [EP8]
- b. Bad Memories – Ways & Means Committee Draft of September 13, 2021 (with sweeping transfer tax/grantor trust provisions) [EP9-12, WU15-18]
 - (1) Reduce Exclusion Amount to \$5 Million (Indexed) on January 1, 2022
 - (2) Grantor Trusts – inclusion in gross estate, distributions (other than to grantor or grantor’s spouse) treated as gifts, gift treatment if trust ceases to be grantor trust during grantor’s life, transfers between deemed owner and grantor trust may be sales (treatment of deemed owner as owner of the trust would be disregarded)
 - (3) Look-Through Valuation of Nonbusiness Assets in Entities
 - (4) Increased Benefit of Special Use Valuation
 - (5) Various Income Tax Proposals – most of the rate increase proposals were eventually deleted from the proposal but left in was a 5% and 8% surcharge on modified AGI over \$10 million/\$25 million (\$200,000/\$500,000 for trusts and estates)

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- c. "Slimmed Down" Reconciliation Package Enacted on August 16, 2022, Inflation Reduction Act of 2022 [EP15-19, WU19]
 - (1) Healthcare Provisions – Medicare allowed to negotiate drug prices on some drugs, drug costs under Part D of Medicare capped at \$2,000 annually, Affordable Care Act subsidized premiums extended for three years
 - (2) Climate Change and Energy Provisions
 - (3) Debt Reduction
 - (4) Revenue Raisers – (i) 15% corporate minimum tax on book income over \$1 billion, (ii) 1% stock buyback tax, (iii) \$80 billion boost to IRS
 - (5) NOT INCLUDED – reversal of 2017 tax cuts, imposition of additional taxes on high earners (such as the 5% and 8% surtax), elimination of the carried interest tax break, or any provisions affecting transfer taxes or taxing unrecognized gains.
- d. Likelihood of Further Tax Legislation

2. Miscellaneous IRS Guidance; Priority Guidance Plan

- a. Anti-Abuse Exception to Clawback – Proposed Regulations April 27, 2022 [EP53-57 & 62, WU42-48]
 - (1) Exceptions from anti-clawback relief for "transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b), including without limitation":
 - (a) Traditional "string gifts" (§2036, etc.) [Prop. Reg. §20.2010-1(c)(3)(i)(A)]
 - (b) Enforceable promises [Prop. Reg. §20.2010-1(c)(3)(i)(B)], not limited to cases where it results in a gift (not just "enforceability"), no exception for adequate consideration (See Rev. Rul. 84-25)
 - (c) Certain chapter 14 gifts – vaguely, "transfers described in §25.2701-5(a)(4) or §25.2702-6(a)(1)" [Prop. Reg. §20.2010-1(c)(3)(i)(C)], §2701 examples needed
 - (d) 18-month rule [Prop. Reg. §20.2010-1(c)(3)(i)(D)], possibly derived from the 18-month non-deathbed (more precisely, "not terminally ill") presumption in Reg. §§1.7520-3(b)(3), 20.7520-3(b)(3)(i), and 25.7520-3(b)(3), really "necessary" or just "appropriate"? (see section 2001(g)(2)), not rebuttable? (for example, if death results from an accident or from an illness not detected at the time of the relevant event), no exception for adequate consideration, durational period exception [Prop. Reg. §20.2010-1(c)(3)(ii)(B)] (important for drafting)
 - (2) 5% de minimis rule [Prop. Reg. §20.2010-1(c)(3)(ii)(A)]
 - (3) Applicable to estates of decedents dying on or after April 27, 2022, but as to gifts made since January 1, 2018
- b. New Section 7520 Actuarial Tables – Proposed Regulations May 5, 2022 [EP41-43, WU58-59]
 - (1) What took so long?
 - (2) Election permitted back to January 1, 2021, why not May 1, 2019? (e.g., CLATs)
- c. Section 2053: Present Value Concepts – Proposed Regulations June 28, 2022 [EP44-50, WU50-53]
 - (1) Present-value discounting, with a 3-year "grace period" [Prop. Reg. §20.2053-1(d)(6)], 3 years a "cliff" (compare 35 months and 37 months), will affect almost all estates filing estate tax returns, will reduce effectiveness of *Graegin* loans
 - (2) Interest on loan obligations – "Actually and necessarily incurred ... and essential to the proper settlement of the decedent's estate" test [Prop. Reg. §20.2053-3(d)(1) – note it has been in Reg. §20.2053-3(a) since 1958] might eliminate *any* deduction for *Graegin* loans

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- (3) “Disregard of applicable rules” [Prop. Reg. §20.2053-3(d)(1)(iii)], arguably covers everything? But Preamble distinguishes “legitimate disagreements with the IRS, inadvertent errors, or reasonable reliance on a qualified professional”
- (4) “The estate’s illiquidity ... as a result of the decedent’s testamentary estate plan to create illiquidity” (Prop. Reg. §20.2053-3(d)(2)(viii)) or “illiquidity ... created intentionally ... in the estate planning” (preamble), effect on family businesses trying to keep business in the family (2016 all over again?)
- (5) Choice of lender [Prop. Reg. §20.2053-3(d)(2)(ix) & (x)] – care needed
- (6) Signing appraisals “under penalties of perjury” [Prop. Reg. §20.2053-4(b)(1)(iv)(F) & (c)(1)(iv)(F)]
- (7) Personal guarantee of the debt of an entity [Prop. Reg. §20.2053-4(d)(5)(ii)] – bona fide and adequate consideration requirements met if at the time of the guarantee decedent had an interest in the entity and (i) decedent had control of the entity within the meaning of §2701(b)(2) or (ii) the maximum liability of the decedent under the guarantee did not exceed the fair market value of the decedent’s interest in the entity
- (8) Effective date: Date of publication of final regulations
- d. Portability Extensions (Extended From Two to Five Years) – Rev. Proc. 2022-32 [EP56-57]
- e. What’s Up Next?

3. SECURE Act; Proposed Regulations; New Life Expectancy Tables for RMDs

- a. Applies to 2022 Distributions; For 2021 Distributions Use “Reasonable Good Faith Interpretation” [EP29-30]
- b. A Few Highlights: Life Expectancy Payments During 10-Year Term; Accumulation Trust Rules Simplified; Can Use Accumulation Trust for Minor Child and Disabled/Chronically Ill); Conduit Trust for Spouse [EP237]
- c. New Life Expectancy Table for RMDs (effective for 2022 distributions) [EP38-39]

4. GRAT Developments

- a. CCA 202152018 – Deliberately Undervalued Appraisal Used; “Atkinson Rationale” Applied [EP136-136, WU132-133]
- b. *Baty v. Commissioner* (Tax Ct. Docket No. 12216-21) – Publicly traded price vs. consider merger negotiations; Not adjust GRAT annuity; IRS caved [EP136-140, WU131-132]
- c. *Donoghue v. Smith* (S.D.N.Y. 2022) – Exercise of substitution power in a GRAT subject to Section 16(b) short swing profits rule (having grantor as trustee *may* help qualify for the “mere change in form” exception, but §2036(b) would apply if the grantor can vote stock of a controlled corporation) [EP143-146]

5. Sprinkling CRUTs; IRS Changed Position Denying Marital or Charitable Deduction for Sprinkling Unitrust Interest, CCA 202233014 [EP147-148]

- a. CCA 202233014 (July 12, 2022; release date August 19, 2022)
- b. Prior PLRs 201845014, 201117005, 200832017, and 200813006 allowed full marital deduction for sprinkling unitrust interest, based on legislative history to §2056(b)(8), which provides that the terminable interest rule of §2056(b)(1) does not apply if the surviving spouse is the only noncharitable beneficiary;

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- (1) Section 2056(b)(1) denies a marital deduction if an interest may pass to anyone other than the spouse and such other person may enjoy the property after the termination of the interest passing to the spouse;
- (2) Legislative history “find no justification for imposing transfer taxes on a transfer split between a spouse and a qualifying charity”
- c. Rationale of CCA 202233014 – neither the marital nor charitable interest is ascertainable so no deduction allowed; no discussion of why the §2056(b)(8) reasoning no longer applies

6. *Keefe v. U.S.*, 130 AFTR 2d 2022-5405 (N.D. Tx August 10, 2022) (denying motion for reconsideration of Order), 130 AFTR 2d 2022-5002 (July 6, 2022) [EP149-150]

- a. Assignment of income doctrine applied, so donor recognized income on sale of hotel owned by partnership
 - (1) Assignment was made before property “gave rise to income by way of a sale”; buyer had only tentatively agreed to buy hotel and contract of sale was signed several weeks later subject to 30-day review period
 - (2) But assignment of income doctrine applied because donor assigned only a portion of interest attributable to donated 4% limited partnership interest (proceeds of hotel sale only)
- b. Charity did not properly acknowledge that it had exclusive legal control over donated assets, so income tax charitable deduction denied
- c. Very harsh result

7. *Estate of DeMuth v. Commissioner*, T.C. Memo. 2022-72 (filed July 12, 2022, corrected August 1, 2022), Checks Cashed Post-Death [EP146-147]

- a. Checks written before but cashed after death not completed gifts and includable in gross estate
- b. Planning
 - (1) Charitable Gifts – can get charitable deduction even if check not cashed until the following year
 - (2) End-of-Year Gifts – can treat as gifted in the year the check was unconditionally delivered if it is cashed, deposited or presented for payment within a reasonable time after the check was issued
 - (3) End-of-Life Gifts – Rev. Rul. 96-56 conditions application of the relation back doctrine on the donor still being alive when the check is paid by the drawee bank; *DeMuth* is an example
 - (4) Avoiding Timing Problems – Consider making end-of-year or deathbed gifts by cashier’s check (which cannot be cancelled), by wiring funds, or by electronic transfer

8. *Estate of Levine v. Commissioner*, 158 T.C. No. 2 (February 28, 2022) [EP104-110, WU76-81]

- a. Intergenerational Split Dollar Life Insurance
- b. Key Facts (mother advanced \$6.5M; only ILIT that owned policies could terminate early; unrelated business associate controlled insurance for ILIT and very unlikely to terminate early because of fiduciary duties owed to grandchildren as ILIT beneficiaries)
- c. Sections 2036, 2038 (fiduciary duties; mere ability to amend contract not “in conjunction with” under §§2036(a)(2), 2038); Section 2703 (not distinguishing contrary analysis in *Estate of Cahill*)

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9. *Smaldino v. Commissioner*, T.C. Memo. 2021-127 [EP125-133, WU130-131]

- a. Indirect Gift (“purported” gift of LLC interest to wife followed by gift the next day from wife to trust for descendants [to use wife’s exclusion]; terrible facts, including express agreement to re-transfer)
- b. Planning Implications (especially important for SLATs) – Avoid express agreements to make subsequent gift, structure so that facts support independent decision to make subsequent transfer, allow passage of time, do not re-transfer exact same assets or amount, report transfers correctly, retain assets long enough to receive some distributions from the gifted asset, wait until subsequent calendar year before making re-transfers

10. Corporate Transparency Act and Proposed Regulations (Dec. 8, 2021) [EP23-26]

- a. National Beneficial Ownership Registry of “Small” Businesses (For Law Enforcement) – “Reporting Companies” must report “Applicants” (who applied to form the entity) and “Beneficial Owners”
 - (1) Reporting Companies include corporations, LLCs, and LPs (but probably not private trusts), but several exemptions apply including (i) entities that employ more than 20 people and have gross receipts exceeding \$5 million, (ii) specified entities already under close federal regulation, and (iii) certain entities with no active trade or business
 - (2) Beneficial Owners are individuals who directly or indirectly exercise substantial control over the company or own or control at least 25% of the company (specified exceptions are provided). Proposed regulations state that for trusts, the Beneficial Owners are (i) trustees, (ii) a trust beneficiary who is the sole permissible recipient of income and principal or who can demand distribution of or withdraw substantially all of the trust assets, and (iii) the trust grantor or settlor who has the right to revoke the trust or otherwise withdraw all of its assets
- b. Filing Due Dates and Penalties – Existing companies, 1 year after final regulations effective date; New companies, 14 days after formation of the entity; Failure to report or willfully providing false information will result in civil and criminal fines (penalties of \$500/day the report is outstanding, up to \$10,000) and up to two years imprisonment
- c. Final Regulations Expected by December 31, 2022

11. Early Termination of Trusts; Commutation of Spouse’s Interest in QTIP Trust

- a. Early Termination of Trusts – Substantial Income Tax Costs (IRS position is that remainderman purchases interest of current beneficiary [who may have zero basis under the §1001(e) uniform basis rule] AND remainderman recognizes gain on assets paid out to others), PLRs 201932001-201932010 [EP74-75]
- b. PLR 202016002; CCA 202118008 – Commutation of QTIP Trust [EP76]
- c. Complexity of Planning with QTIP Trust Interests (*see* Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. MIAMI HECKERLING INST. ON EST. PLAN. ¶1202.3 (2010); Richard S. Franklin, *Lifetime QTIPs – Why They Should Be Ubiquitous in Estate Planning*, 50th U. MIAMI HECKERLING INST. ON EST. PL. ch. 16 (2016))
- d. CCA 202206008 – Trust Modification to Add Formula General Power of Appointment [EP77-80]

12. Valuation and Formula Issues

- a. *Estate of Moore*, T.C. Memo. 2020-40, *aff’d* 124 AFTR 2d 2021-6604 (9th Cir. Nov. 8, 2021) (charitable formula transfer not recognized by Tax Court; affirmed on appeal, but on narrow grounds) [EP80-86, WU94-112]

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- b. *Nelson*, T.C. Memo. 2020-81, *aff'd*, 17 F.4th 556 (5th Cir. Nov. 3, 2021) (appeal: assignments were not defined value transfers based on finally determined values) [EP86-89, WU112-121]
- c. *Estate of Warne v. Commissioner*, T.C. Memo. 2021-17 (valuation of majority interests in LLCs owning real estate [4% LOC & 5% LOM discounts]; charitable deduction based on values passing to each separate charity) [EP89-95, WU121-127]
- d. *Estate of Michael Jackson*, T.C. Memo. 2021-48 (valuation of publicity rights; undervaluation penalties; tax-affecting [not following *Estate of Jones* (T.C. Memo. 2019-101)]) [EP96-101, WU127-130]
- e. *Estate of Morrisette*, T.C. Memo. 2021-60 (no §2036, 2038 or 2703; valued reimbursement rights with very little discount; undervaluation penalties applied despite reputable appraisals) [EP101-103, WU73-76]
- f. *Connelly v. U.S.*, 128 AFTR 2d 2021-5955 (E.D. Mo. Sept. 2, 2021) (buy-sell agreement did not fix estate tax value; corporate purchase obligation funded with corporate-owned life insurance; value increased by life insurance proceeds used to fund purchase of decedent's shares) [EP115-122]
- g. *Buck v. U.S.*, 128 AFTR 2d 2021-6043 (D.C. Ct. Sept. 24, 2021) (undivided gifts to separate donees in each of four years valued separately and not aggregated) [EP122-125]

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