

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 “Heckerling Musings 2023 and Estate Planning Current Developments” (April 2023) (EP) and the “Washington Update: Pending and Potential Administrative and Legislative Changes” (March 2023) (WU), both available at www.bessemertrust.com/for-professional-partners/advisor-insights.]

1. Legislative Proposals

- a. FY 2023 and 2024 Greenbooks; Administration Priorities [EP1-5, WU23-32]
 - (1) Business Tax Provisions – Increase corporate rate from 21% to 28%, reduce basis shifting by related parties through partnerships [EP1]
 - (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” [EP1-2, WU23-27]
 - (3) Estate and Gift Proposals [EP2-4, WU27-44]
 - (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) [EP2, WU32]
 - (b) Grantor Trusts (recognition of gain on sales transactions with grantor trusts [effective for transactions after date of enactment], treating payment of income tax by deemed owner of grantor trust as a gift [effective for trusts created after date of enactment]) [EP2, WU32-33]
 - (c) Limitation on Defined Value Clauses (not allowed except for defining a marital or exemption equivalent bequest based on remaining exclusion amount) (added in FY2024 Greenbook, “FY24”) [EP3, WU28-30]
 - (d) Consistent Valuation of Promissory Notes [EP2, WU35-37]
 - (e) Valuation of Fractional Interests and Interests in Entities (look-through if transferor’s family owns at least 25%; not-very-clear exception for operating businesses) (FY24) [EP4, WU37-39]
 - (f) “Simplify” Gift Tax Annual Exclusion (limited to \$50,000 for restricted gifts) (FY24) [EP3, WU30-31]
 - (g) Limited Duration of GST Exemption (only for first or second generation beneficiaries or later generation persons alive at trust creation; treat old trusts as if created on date of enactment; inclusion ratio adjusted upon purchase from another trust or the making or repayment of loans; certain tax-exempt organizations ignored in determining GST tax status) [EP2, WU31-34]
 - (h) Loans from Trusts (creating as carrying out DNI and distributions for GST tax purposes (FY24) [EP4]
 - (i) Modifying Definition of CLAT Annuity (eliminating zeroed-out and “shark-fin” CLATs) (FY24) [EP4, WU34]
 - (j) Miscellaneous Other Provisions [EP4-5, WU27-28]
 - (k) Not Included – reduction of exclusion amount prior to 2026, inclusion of grantor trust assets in gross estate

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- (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 [EP2,4]
- b. Bad Memories – Ways & Means Committee Draft of September 13, 2021 (with sweeping transfer tax/grantor trust provisions) [WU15-19]
- c. “Slimmed Down” Reconciliation Package Enacted on August 16, 2022, Inflation Reduction Act of 2022 [EP5-7, WU19-21]
 - (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. **Wandry Clause Gift Tax Case Settled, *Sorensen v. Commissioner*, T.C. Docket 24797-18, 24798-18, 20284-19, 20285-19 (Decision Entered Aug. 22, 2022) [EP62-67]**

- a. Recent Example of IRS Arguments Against a *Wandry* Clause
- b. Settlement – Defined value clause did not control gift of shares (enforcement of the clause would have caused several hundred million dollars to be “adjusted” from trusts to two donors)
- c. Planning Observations
 - (1) Treatment of *Wandry* transfers varies among IRS estate and gift tax attorneys
 - (2) For late-year gifts (when impossible to get appraisal by year end), could use *Nelson* approach
 - (3) Beware of *Wandry* transfer if transferred asset could explode in value
 - (4) Reporting consistency (stock ledger, distributions, donee acknowledgment of stock power, third parties)
 - (5) Use updated appraisals (using a 3-month old appraisal may have resulted in 10% penalty where conditions changed)
 - (6) Fractional shares (would have avoided an IRS argument of inconsistency) [round down to nearest one-tenth or one-hundredth of a unit]

3. **Miscellaneous IRS Guidance; Priority Guidance Plan**

- a. Inflation Adjusted Amounts, Rev. Proc. 2022-38 [EP30]
 - (1) Basic exclusion amount and GST exemption-\$12,920,000 (an increase of \$860,000 from 2022!)
 - (2) Gift tax annual exclusion- \$17,000 (from \$16,000 in 2022 and \$15,000 in 2018-2021)
 - (3) Estates and trusts taxable income for top (37%) income tax bracket-\$14,450 (\$13,450 in 2022)

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- b. Priority Guidance Plan for 2022-2023 (released November 4, 2022) adds three new projects in the “Gifts and Estates and Trusts” section [EP25]
 - (1) Guidance regarding availability of §1014 basis adjustment at the death of the owner of a grantor trust described in §671 when the trust assets are not included in the owner’s gross estate for estate tax purposes; issued as Rev. Rul. 2023-2 on March 29, 2023 [EP26-27, WU54-56]
 - (2) Regulations under §20.2056A-2 for qualified domestic trust elections on estate tax returns, updating obsolete references [WU69]
 - (3) Guidance on portability regulatory elections under §2010(c)(5)(A) (extended from two years to five years) [already published as Rev. Proc. 2022-32] [EP27-28, WU63-64]
- c. Letter From Senators Requesting Regulatory Crackdown on GRATs, Grantor Trusts, FLP Discounts [EP29-30]
- d. Anti-Abuse Exception to Clawback – Proposed Regulations April 27, 2022 [EP31-35, WU56-63]
 - (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
- e. New Section 7520 Actuarial Tables – Proposed Regulations May 5, 2022 [EP41-44, WU75-76]
 - (1) What took so long?
 - (2) Election permitted back to January 1, 2021, why not May 1, 2019? (e.g., CLATs)
- f. Section 2053: Present Value Concepts – Proposed Regulations June 28, 2022 [EP35-41, WU67-69]
 - (1) Present-value discounting, with a 3-year “grace period” [Prop. Reg. §20.2053-1(d)(6)], 3 years is 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
 - (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”

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- (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: Estates of decedents dying on or after the date of publication of final regulations

4. Corporate Transparency Act and Final Regulations (Sept. 29, 2022) [EP10-12]

- a. National Beneficial Ownership Registry of “Small” Businesses (For Law Enforcement) – “Reporting Companies” must report “Applicants” and “Beneficial Owners.” Purpose – help combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity.
 - (1) Reporting Companies include corporations, LLCs, and LPs (but 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) Applicants are individuals who applied to form the entity. Final regulations clarify that information about Applicants must only be filed for companies created after the effective date of the regulations (January 1, 2024), and changed information does not have to be reported for Applicants. Final regulations also provide that only one or possibly two individuals have to be identified as Applicants (the individual who files the organizational document and the individual primarily responsible for directing such filing).
 - (3) 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). Final 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. Final Regulations regarding beneficial ownership reporting were released September 29, 2022, with an effective date of January 1, **2024**.
- c. Filing Due Dates and Penalties – Existing companies, 1 year after final regulations effective date (i.e., by January 1, 2025); New companies, 30 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.
- d. Proposed regulations were issued on December 15, 2022, governing the disclosure, access, and safeguarding of beneficial ownership information.
- e. More may come. The “Establishing New Authorities for Business Laundering and Enabling Risks to Security Act,” or ENABLERS Act, would expand the list of “gatekeepers” who are required under the Bank Secrecy Act to conduct due diligence on clients and file suspicious activity reports, and the

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expanded list would include attorneys who assist in financial-related transactions such as the formation of companies and trusts. The ENABLERS Act passed the House of Representatives on July 14, 2022, on a 329 to 101 vote (obviously with broad bipartisan support). [EP11-12]

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

- a. Notice 2022-53 – clarifies that regulations will apply no earlier than 2023 and waives the 50% penalty for failing to make required minimum distributions in 2021 or 2022 [EP20-21]
- 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 [EP16-19]
- c. New Life Expectancy Table for RMDs (effective for 2022 distributions) [EP21]
- d. SECURE 2.0 was part of the Consolidated Appropriations Act, 2023 enacted December 29, 2022. Extensive provisions expand retirement savings opportunities. A few of the areas of interest to planners include: (1) increased age (73 in 2023 and 74 in 2033) for required beginning date for mandatory distributions, (2) relaxation of rules for qualifying longevity annuity contracts (QLACs), (3) \$100,000 limit for annual qualified charitable distributions from IRAs for owners over age 70 ½ will be inflation-indexed, (4) 401(k) Roth accounts will not have to make minimum distributions during the owner's life, and (5) new complicated spousal election requirements to defer payments and use the uniform life table to determine minimum distribution amounts. [EP22-24]

6. GRAT Developments

- a. CCA 202152018 – Deliberately Undervalued Appraisal Used; “Atkinson Rationale” Applied [EP104-107]
- b. *Baty v. Commissioner* (Tax Ct. Docket No. 12216-21) – Publicly traded price vs. consider merger negotiations; Not adjust GRAT annuity; IRS caved [EP107-111]
- 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) [EP111-113]

7. Assignment of Income and Availability of Charitable Deduction, *Estate of Hoensheid v. Commissioner*, T.C. Memo. 2023-34 (March 15, 2023); *Keefer v. U.S.*, 130 AFTR 2d 2022-5405 (N.D. Tx August 10, 2022) (denying motion for reconsideration of Order), 130 AFTR 2d 2022-5002 (July 6, 2022) [EP117-127]

- a. *Estate of Hoensheid v. Commissioner*
 - (1) Assignment of income doctrine applied (“already fixed or vested right”; “donor must bear at least some risk at the time of contribution that the sale will not close”; sale was “virtually certain to occur”)
 - (2) Charitable deduction denied because of failure to provide “qualified appraisal”
 - (3) No penalty because of reasonable reliance on attorney’s advice (even though it was wrong)
- b. *Keefer v. U.S.*
 - (1) Assignment of income doctrine applied, so donor recognized income on sale of hotel owned by partnership

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- (a) 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
- (b) 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)
- (2) Income tax charitable deduction denied because charity did not properly acknowledge that it had exclusive legal control over donated assets

8. *Estate of Cecil v. Commissioner*, T.C. Memo. 2023-24 (Feb. 28, 2023) [EP128-135]

- a. Gift tax valuation of voting and nonvoting stock of S corporation that owned Vanderbilt Biltmore House in Asheville, North Carolina
- b. Taxpayer and IRS experts both tax affected earnings of the S corporation in valuing the company under the income approach because the data used for the valuation were largely based on data from C corporations
- c. No total bar to using tax affecting (after reviewing prior cases that rejected or allowed tax affecting)
- d. Holding based on fact that experts on each side agreed to using tax affecting and the tax affecting specific method
- e. “[W]e are not necessarily holding that tax affecting is always, or even more often than not, a proper consideration for valuing an S corporation.”
- f. Other recent tax affecting cases: *Estate of Michael Jackson*, T.C. Memo. 2021-48 (rejected tax affecting because taxpayer’s experts had not persuaded the court that the buyers would be C corporations) [EP89,134]; *Estate of Jones*, T.C. Memo. 2019-101 (allowed tax affecting; “we do not have a fight between valuation experts but a fight between lawyers”) [EP133-134]

9. *Sprinkling CRUTs; IRS Changed Position Denying Marital or Charitable Deduction for Sprinkling Unitrust Interest*, CCA 202233014 [EP116-117]

- 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
 - (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[s] 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

10. *Estate of DeMuth v. Commissioner*, T.C. Memo. 2022-72 (filed July 12, 2022, corrected August 1, 2022), *Checks Cashed Post-Death* [EP114-115]

- a. Checks written before but cashed after death not completed gifts and includable in gross estate
- b. Planning

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- (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

11. *Estate of Levine v. Commissioner*, 158 T.C. No. 2 (February 28, 2022) [EP89-93]

- 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*)

12. Trust Modification to Add Formula General Power of Appointment, CCA 202206008

- a. Trust modifications are allowed for various reasons under state laws [EP144-146]
- b. CCA 202206008 allowed a trust modification to add a formula general power of appointment (for basis adjustment purposes); but do not use that formula as a template [EP84-87]

13. Valuation, Formula, and Indirect Gift Issues

- a. *Smaldino v. Commissioner*, T. C. Memo. 2021-127 (indirect gift; “purported” gift of LLC interest to wife followed by gift the next day from wife to trust for descendants [to use wife's exclusion]) [EP101-103]
- b. *Estate of Michael Jackson*, T.C. Memo. 2021-48 (valuation of publicity rights; undervaluation penalties; tax-affecting not appropriate because taxpayer's experts had not persuaded the court that the buyers would be C corporations) [EP89,134]
- c. *Nelson*, T.C. Memo. 2020-81, *aff'd*, 17 F.4th 556 (5th Cir. 2021) (appeal: assignments were not defined value transfers based on finally determined values) [EP62]
- d. *Estate of Moore*, T.C. Memo. 2020-40, *aff'd* 124 AFTR 2d 2021-6604 (9th Cir. 2021) (charitable formula transfer not recognized by Tax Court; affirmed, but on narrow grounds) [EP71-72 & 81]
- e. *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) [EP84]
- f. *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) [EP87-89]
- g. *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)
- h. *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)

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