FEDERAL ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAX RECENT DEVELOPMENTS*

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*The outline highlights select developments from January 2019 through December 2019 focusing on key points relevant to the code section under which it appears. The outline reflects the views of the author and not those of the University of Montana.
I. FEDERAL ESTATE TAX

A. Key Inflation Adjusted Amounts
Treasury issued estate, gift and generation-skipping transfer tax inflation adjusted amounts for 2020 as part of Revenue Procedure 2019-44, 2019 I.R.B. LEXIS 414 (Nov. 6, 2019), revising the 2019 amounts previously published as part of Revenue Procedure 2018-57, I.R.B. 2018-49 (Nov. 16, 2018). The inflation adjusted amounts for 2020 impacting wealth transfers are as follows:

1. Basic Exclusion Amount and GST Exemption
   The formerly named Tax Cuts and Jobs Act, P.L. 115-97, doubled the basic exclusion amount and GST exemption from an indexed $5 million to an indexed $10 million amount effective for tax years 2018 through 2025. I.R.C. § 2010(c)(3)(C); I.R.C. § 2505(a). The basic exclusion amount for federal estate and gift tax during 2020 increases to $11,580,000 from its former 2019 amount of $11,400,000. The generation-skipping transfer tax exemption is the same amount. Treasury issued final regulations ruling out the possibility of a “clawback” of basic exclusion amount in the event the basic exclusion amount in fact halves in 2026, and those final regulations are discussed below.

2. Gift Tax Annual Exclusion
   The federal gift tax annual exclusion amount of $10,000 adjusts for inflation for years following 1998. I.R.C. § 2503(b). The per-person per-year exclusion from gift tax for 2020 remains $15,000. For non-U.S. citizen spouses the annual gift tax exclusion amount for 2020 increases to $157,000 from the former 2019 amount of $155,000. See I.R.C. § 2523(i)(2).

3. Special Use Valuation Limitation
   The special use valuation election is limited to $750,000 as that amount is adjusted for inflation after 1998. I.R.C. § 2032A(a)(3). The special use valuation limitation increases to $1,180,000 for 2020, up from the 2019 amount of $1,160,000.

4. Section 6166 2-Percent Amount
   If an I.R.C. Section 6166 election is made to defer tax, a certain portion of the estate tax to be paid will bear interest at the rate of 2 percent. The 2 percent portion is determined based on a formula specified per I.R.C. 6601(j), specifically, an amount equal to the tentative tax on the sum of $1 million (as that amount is adjusted for inflation) and the applicable exclusion amount, less the applicable credit amount. The $1 million amount increases in 2020 to
$1,570,000, up from the 2019 amount of $1,550,000. Accordingly, in 2019, the 2 percent portion would be calculated as follows: The tentative tax on the sum of $1,570,000 and $11,580,000, which equals 13,150,000, is $5,205,800. That amount less the applicable credit amount for 2020 of $4,577,800 is $628,000. Thus, the 2 percent portion as calculated for 2019 is $628,000.

B. Section 2010: Unified Credit


_Treasury Essentially Adopts Proposed Anti-Clawback Regulations as Final, With Warning of an Anti-Abuse Rule Forthcoming_

In issuing final basic exclusion amount (BEA) anti-clawback regulations, Treasury essentially adopts with clarifying provisions the rules of the proposed regulations published one year earlier, almost to the day. The effective date of the BEA anti-clawback regulations, or “the special rule,” as it is referenced in the regulations is November 22, 2019, the date the final regulations were published in the Federal Register.

The final anti-clawback regulations, like the proposed regulations, allow a decedent’s estate to benefit from the greater of the credit attributable to the BEA used to shelter gifts and the credit attributable to the BEA at decedent’s death. Think of it as a “greater of” rule. The decedent’s estate gets the benefit of the greater credit attributable to BEA – the BEA sheltering aggregate gifts or the BEA at date of death.

_Treasury’s Response to Comments – Preamble to the Final Regulations_

The preamble to the final regulations and clarifying rules and examples included as part of the final regulations address some of the questions raised by commentators in regard to the proposed regulations. The preamble to the final regulations specifically confirms:

- The BEA anti-clawback rule or ‘the special rule,’ makes the temporary increase in BEA a “‘use or lose’ benefit.” This means, for a taxpayer who survives until 2026, the taxpayer must make gifts in excess of the anticipated inflation adjusted BEA at the taxpayer’s death in order to obtain any benefit from the temporary increase in BEA.
- The BEA anti-clawback rule, or ‘the special rule,’ takes into account only “gifts actually made.” The preamble confirms the special rule does not
apply if a decedent did not in fact make gifts exceeding the expected date of death BEA, as adjusted for inflation.

- A decedent, who makes gifts prior to 2026 in an amount greater than the inflation-adjusted date of death BEA, will not benefit from post-2025 inflation adjustments.
- The BEA is applied first to taxable gifts made by decedent, and only that remaining is applied to transfers at death. The BEA is applied to gifts from the first dollar of BEA, with the temporary increase used only to the extent taxable gifts up to that amount have been made.
- The deceased spousal unused exclusion amount (DSUEA) does not change once elected. If a married decedent dies prior to 2026 and the decedent’s estate makes a portability election, the DSUEA ported to the surviving spouse is equal to the BEA at the decedent’s death, and that amount will not change even if the survivor lives beyond 2025.
- If a donor’s applicable exclusion amount (AEA) is comprised of both BEA and DSUEA, the DSUEA is used first to shelter the taxable gift, and then the BEA. The BEA anti-clawback rules essentially adopt the same ordering rule provided by the DSUEA anti-clawback rules.
- If a donor uses both DSUEA and BEA to shelter a gift, for purposes of the special rule, the aggregate credit attributable to the BEA used to shelter gifts is the portion determined by dividing the BEA by the AEA allocable to the gifts made.

**The Rules of the Final Regulations and Examples**

The regulations implement these principals by adopting the special rule of the proposed regulations. The special rule, provides:

(c) *Special rule in the case of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor’s death.*

Changes in the basic exclusion amount that occur between the date of a donor’s gift and the date of the donor’s death may cause the basic exclusion amount allowable on the date of a gift to exceed that allowable on the date of death. If the total of the amounts allowable as a credit in computing the gift tax payable on the decedent’s post-1976 gifts, within the meaning of section 2001(b)(2), to the extent such credits are based solely on the basic exclusion amount as defined and adjusted in section 2010(c)(3), exceeds the credit allowable within the meaning of section 2010(a) in computing the estate tax, again only to the extent such credit is
based solely on such basic exclusion amount, in each case by applying the tax rates in effect at the decedent’s death, then the portion of the credit allowable in computing the estate tax on the decedent’s taxable estate that is attributable to the basic exclusion amount is the sum of the amounts attributable to the basic exclusion amount allowable as a credit in computing the gift tax payable on the decedent’s post-1976 gifts.

Treas. Reg. § 20.2010-1(c).

The final regulations add clarifying “computational” rules that were not included in the proposed regulations. To ensure the “use it or lose it” rule applies and that gifts must actually be made, the computational rule indicates the credit allowable cannot exceed the tentative tax on gifts made for the taxable period or the tentative tax on the taxable estate, whichever applies. Treas. Reg. § 20.2010-1(c)(1)(i). To ensure the same ordering rules apply as apply under the DSUEA anti-clawback rules, if a gift is sheltered in part by DSUEA and in part by BEA the BEA, BEA anti-clawback regulations specifically provide DSUEA is deemed used prior to the BEA of the donor/decedent. Treas. Reg. § 20.2010-1(c)(1)(ii)(A). In addition the regulation provides, if a DSUEA is applied, the BEA used is only that necessary to reduce tentative gift tax to zero. Treas. Reg. § 20.2010-1(c)(1)(ii)(B) Finally a computational rule is added to calculate the credit attributable to the BEA used when making a gift. The ‘BEA portion’ of the credit used to shelter gifts is the portion determined by dividing the BEA allocated by the AEA allocated to the gifts. Treas. Reg. § 20.2010-1(c)(1)(ii)(C). This final computational rule isolates the reach of the special rule to the BEA only. Treas. Reg. § 20.2010-1(c)(1)(iii).

To illustrate the special rule and the addition of the computational rules, the final regulations expand the examples to 4 and use hypothetical inflation adjusted amounts. See Treas. Reg. § 20.2010-1(c)(2). The example of the proposed regulations was criticized for not illustrating the reality of inflation adjustments. The examples respond directly to concerns raised by commenters.

Examples 1 and 2 demonstrate the special rule when the donor/decedent’s AEA consists solely of BEA, and no restored BEA is involved. The two examples demonstrate the special rule treats the temporary increase in BEA as a “use or lose” benefit, the BEA is used only to the extent of actual gifts made, decedent will not benefit from post-2025 inflation adjustments, and the BEA is applied first to taxable gifts.
Example 1 addresses lifetime gifts made in excess of the inflation adjusted BEA as of the donor/decedent’s date of death. Example 1 is essentially as follows:

Alan, an unmarried individual, made $9 million of post-1976 cumulative taxable gifts, all of which were sheltered from gift tax by the allowable $11.4 million BEA as of the date of the gifts. The BEA on Alan’s death equaled only $6.8 million. Because the total amount allowable as a credit in computing gift tax, based on the $9 million BEA, exceeded the credit for purposes of computing estate tax, based on the $6.8 million BEA as of donor’s/decedent’s date of death, the credit allowable for estate tax purposes is the credit determined on a BEA of $9 million, which was the BEA used to determine the credit necessary to zero out gift tax on the $9 million of taxable gifts.


Example 2 addresses lifetime gifts aggregating less than the BEA allowable on the donor/decedent’s date of death. It is essentially as follows:

Assume instead that Alan, an unmarried individual, made $4 million of post-1976 taxable gifts, all of which were sheltered from gift tax by the allowable $11.4 million BEA as of the date of the gifts. The BEA on Alan’s death equaled only $6.8 million. Because the total amount allowable as a credit in computing the gift tax paid on the gifts is less than the credit based on the $6.8 million BEA at death, the special rule does not apply. The credit for purposes of determining the estate tax is based on the $6.8 million BEA as of Alan’s date of death.


Examples 3 and 4 address the application of the special rule when donor/decedent’s AEA consists of both DSUEA and BEA. Example 3 demonstrates that once elected the DSUEA ported will not change. Example 4 demonstrates the order in which the DSUEA and the BEA apply to shelter gifts, and the portion of the BEA used in the event both DSUEA and BEA are applied.

Example 3 addresses the making of the portability election where a spouse dies prior to 2026. It is essentially as follows:
Spouse Carol dies prior to 2026 when the BEA is $11.4 million. Carol made no taxable gifts and her taxable estate was zero. Carol’s personal representative made a portability election to allow Carol’s surviving spouse Bob to obtain an $11.4 million DSUEA. Bob also made no taxable gifts and never remarried. At his death the BEA equaled $6.8 million. On Bob’s death, the special rule does not apply because Bob made no taxable gifts so the credit applied to taxable gifts was zero and, thus, the credit on $6.8 million is greater. The credit to be applied for purposes of computing Bob’s estate tax is based on an applicable exclusion amount of $18.2 million, comprised of the $11.4 million ported DSUEA and the $6.8 million BEA at Bob’s death.


Example 4 builds on the facts of Example 3 to address application of the special rule when a donor with an AEA consisting of both the DSUEA and the BEA makes a taxable gift prior to 2026. It demonstrates the ordering rule requiring application of DSUEA before BEA, and how to determine what portion of the portion of the credit attributable to BEA. It is essentially as follows:

Assuming the same facts as Example 3, following Carol’s death and before he dies, Bob makes a $14 million taxable gift in a year when the BEA equals $12 million. Bob’s AEA consists of DSUE amount of $11.4 million and BEA of $12 million at the time of the gift. The credit allowable in computing the gift tax payable is $5,545,800, which is the tax $14 million consisting of $11.4 million in DSUEA and $2.6 million in BEA. The portion of BEA used is 18.6 % or $2.6 million divided by $14 million. To apply the special rule, the credit based solely on the BEA applied to taxable gifts is $1,031,519 or 18.6% multiplied by $5,545,800. Because that amount is less than the credit of $2,665,800 on the $6.8 million BEA in effect at Bob’s death, the special rule does not apply. The credit to be applied for Bob’s estate tax is based on an AEA of $18.2 million consisting of $11.4 million DSUE and the $6.8 million BEA effective at Bob’s death.


Possible Anti-Clawback Rule to Be Promulgated
The preamble to the final regulations makes further important observations impacting planning decisions. Most importantly, it addresses an anti-abuse rule recommended by a commenter. Specifically the commenter urged adoption of a rule “to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes.” The commenter was likely referring to a planning strategy outlined by Eric Viehman, in a presentation titled *Using An Enhanced Grantor Retained Income Trust (E-Grit) to Preserve the Basic Exclusion Amount*, see, 2019 ACTEC Annual Meeting, Estate and Gift Tax Committee Materials. The E-Grit strategy outlined suggests an $11.4 million transfer to a grantor retained income trust (GRIT) for the benefit of the donor. Provided the transfer results in a completed gift, I.R.C. Section 2702 would apply to treat the retained interest as having a zero value and the taxable gift to be the entire $11.4 million. The strategy would allow donor to use the temporary increase in BEA and at the same time retain use of the property transferred. If donor dies during the term of the retained interest, I.R.C. Section 2036 would apply to include the trust assets in the decedent’s gross estate, the special rule, nevertheless, would allow the estate to determine the estate tax credit based on the greater BEA used to shelter the transfer as of the date of gift. The strategy would also have the side benefit of a fair market value basis for GRIT assets if donor dies within the term of the retained interest.

The preamble warns against this strategy, despite lack of any anti-abuse rule in the final regulations. It states:

> The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. *An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor’s gross estate at death.* Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

(Emphasis added.) The broad reach of the warning proves worrisome. Many strategies in fact transfer legally enforceable rights to property to beneficiaries
other than the donor and yet the Code will require gross estate inclusion. To base the anti-abuse rule on whether there is a bona fide transfer would invite litigation – when is a gift bona fide and when is it not. Isn’t donative intent sufficient? Must there be a non-tax motive for every gift? At the same time, to exclude transfers intended to benefit others from the special rule simply because the special valuation rules, I.R.C. § 2701 through 2704 would cause gross estate inclusion would likely not meet the spirit of Congress’ direction to Treasury to promulgate anti-clawback rules. How should the rule apply if it was not the taxpayer’s intent the property be included in the gross estate and yet the Service takes the position in an audit? While an E-GRIT with only the donor as beneficiary may not pass the smell test, should a grantor retained interest trust, which includes other discretionary beneficiaries such as descendants to whom the trustee makes distributions be precluded from the protection of the BEA anti-clawback rules. Where and how should the line be drawn? Issuance of a broad anti-clawback rule would undermine the ultimate purpose of anti-clawback rules, which is to ensure taxpayers that transfers using the temporary increase will not later be subject to tax.

No Rules Addressing GST Issues

The preamble rejected the opportunity to address a GST tax issue raised by “several commenters.” Commenters requested confirmation that donors may allocate the temporary increase in BEA reflected in the GST exemption to intervivos trusts created before 2018. The preamble sidesteps the issue indicating the effect of the temporary increase in BEA on GST allocation “is beyond the scope of this project.” When asked to confirm allocations of GST exemption attributable to the temporary increase in BEA will not be reduced as a result of the sunset, the preamble again sidesteps the issue, but goes on to state in partial response: “There is nothing in the statute that would indicate that the sunset of the increased BEA would have any impact on allocation of the GST exemption available during the increased BEA period.”

With regard to allocation of the corresponding increase in GST exemption, it is worth noting that the Joint Committee of Taxation General Explanation of 2017 Legislation (December 2017), also known as, the Blue Book, page 89, Explanation of the Temporary Increase in Basic Exclusion Amount, indicates in footnote 372 a taxpayer may allocate increased GST exemption to GST trusts previously created by transferor that are not fully exempt. The footnote provides the following clarifying example:
“For example, assume that on March 15, 2016, T gave property with a value of $6,000,000 to a trust for the benefit of T’s descendants (Trust A) and T’s entire then-remaining generation skipping transfer tax exemption of $5,400,000 was allocated to trust A on a timely filed 2016 gift tax return. As of the date of the 2016 gift, Trust A has an inclusion ratio of 0.100 \( [1 \div (5,400,000/6,000,000)] \). On July 1, 2018, when the property in Trust A has a fair market value of $7,000,000, T files a gift tax return and allocates $700,000 of generation-skipping transfer tax exemption to Trust A, reducing Trust A’s inclusion ratio from 0.100 to zero \( [1 \div ((700,000 + (90\% \times 7,000,000)) / 7,000,000)] \), effective on July 1, 2018. Absent additional contributions to Trust A, the generation-skipping transfer tax on taxable distributions from, or a taxable termination with respect to, Trust A on or after July 1, 2018, is determined using an inclusion ratio of zero.”

This footnote confirm the ability to make an allocation of increased exemption to a prior transfer made at a time when the GST exemption was not sufficient to fully protect the transfer from GST taxation.

Maintains Use of Temporary Increase Should Be Isolated to Pre-2026 Use

The preamble rejects outright comments suggesting the temporary increase should be used first. The preamble notes the suggestion is “inconsistent with the sunset in that it, in effect, would extend the …increased BEA beyond 2025.” It further notes it would be inconsistent with the “cumulative structure” in determining estate tax.

2. Private Letter Ruling 201902027 (Released Jan. 11, 2019)

Extension Issued to Make Portability Election. In 2017, Treasury approved a simplified procedure for obtaining an extension to file a late portability election. Revenue Procedure 2017-34, 2017-34 I.R.B. 1282, however, allows the simplified procedure only if the estate makes the election within the date two years after the date of decedent’s death. If the request is made within the 2 year limit, the estate may file the return to elect portability and simply indicate it is made pursuant to the revenue procedure. The simplified procedure only applies if the estate would not need to file an estate tax return but for the need to make the portability election. Revenue Procedure 2017-34 indicates the Service will continue to address private letter ruling requests for an extension in other cases.

In Private Letter Ruling 201902027 the Service grants an extension to make the portability election under the 9100 regulations. In discussing whether the
standard for granting an extension is met, the ruling states: “Therefore, the Commissioner has discretionary authority under § 301.9100-3 to grant an extension of time for Decedent's estate to elect portability, provided Decedent's estate establishes it acted reasonably and in good faith, the requirements of §§ 301.9100-1 and 301.9100-3 are satisfied, and granting relief will not prejudice the interests of the government. Information, affidavits, and representations submitted on behalf of Decedent's estate explain the circumstances that resulted in the failure to timely file a valid election.”

As in prior rulings, the Service does not provide an indication the taxpayer must actively seek advice to meet the reasonable diligence requirement. Prior rulings, as does 201902027, suggest the following statements need to be made to obtain a favorable ruling granting an extension: (1) a statement that the need to file was discovered after the due date for filing the estate tax return on which the election was required to be made, and (2) a statement that the aggregate of the value of decedent’s gross estate and lifetime gifts does not exceed the basic exclusion amount.

Private Letter Ruling 201929017 like earlier 2019 rulings indicates: “Information, affidavits, and representations submitted on behalf of Decedent's estate explain the circumstances that resulted in the failure to timely file a valid election.” The representations as to the facts do not detail the circumstances other than to highlight: “For various reasons, an estate tax return was not timely filed and a portability election was not made. After discovery of this, Decedent's estate submitted this request for an extension of time under § 301.9100-3 to make a portability election.” See also, verbatim language in Priv. Ltr. Ruls. 201947013, 201943014, 201943012, 201943006, 201942006, 201942002, 201929013, 201929017, 201923014, 201923001, 201921008, 201902027, 201852018, 201852016. In Private Letter Ruling 201929013, however, the Service noted taxpayer’s representation that “Spouse's tax advisor did not advise her about the portability election and thus, an estate tax return was not timely filed and a portability election was not made,” and granted the extension on that basis.

C. Section 2031: Inclusion in Gross Estate


Ninth Circuit Affirms Valuation of Paintings. The Ninth Circuit in an unpublished opinion affirms the Tax Court’s holding on valuation of two
paintings. The Ninth Circuit agreed a lack of comparables as of date of death made the taxpayer’s appraisal inadequate. The court further rejected a discount based on the dirtiness of the painting. It cited the statement by the taxpayer’s expert: indicating “the hypothetical buyer would know that cleaning was a well advised and low-risk undertaking.”

2. **Private Letter Ruling 201928003 (March 28, 2019)**

*Service Issues Special Actuarial Factor.* Generally, annuities, life interests, remainder interests and reversionary interests measured by the life of a person who is terminally ill may *not* be actuarially valued. A person is terminally ill if the individual “is known to have an incurable illness or other deteriorating physical condition … if there is at least a 50 percent probability that the individual will die within 1 year.” Treas. Reg. 20.7520-3(b)(3)(i). In Private Letter Ruling 201928003, the Service issued a special actuarial factor of 0.00043 where decedent was determined to be terminally ill under the standard and in fact lived only 5 days after making a disclaimer which resulted in a completed gift.

D. **Section 2032: Alternate Valuation**

*Emailed Chief Counsel Advice 201926013*

*Advice Requires Use of Lowest Value.* In emailed chief counsel advice, ECC 201926013, the email directed use of the valuation date leading to lower gross estate and lower overall estate and GST taxes. The taxpayer made an alternate valuation election based on the assumption values six months following date of death would yield lower overall taxes. In the event that does not turn out to be the case, the valuation date yielding lower overall values must be used. The advice analogized to the protective election allowed to be made in the event special use valuation is found to later yield a lower tax result.

E. **Section 2032A: Special Use Valuation**


*Treasury Issues Interest Rate for Computing Special Use Value.* Revenue Ruling 2019-18 publishes average annual effective interest rates to be used in computing special use value for 2019. Examples as to use of these rates are included in Rev. Rul. 81-170, 1981-1 C.B. 454.


*Service Grants Extension to Elect Special Use Valuation.* The Service granted estate an extension to elect special use valuation where both attorney and CPA filing estate tax return failed to make the election. The extension was granted pursuant to the 9100 regulations, Treas. Reg. § 301.9100-3. The Service noted:
“Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.”

F. Section 2042: Life Insurance

1. Private Letter Ruling 201919002 (May 19, 2019)

Service Rules on Gross Estate Inclusion of Life Insurance Where Former Trustee Is Insured. In Private Letter Ruling 201919002 taxpayer requests ruling that a trustee-beneficiary of a trust created by the trustee-beneficiary’s parent will not be deemed to hold incidents of ownership in a life insurance policy to be purchased on the life of the beneficiary by the trust. Child’s parent, who had since deceased, had previously created irrevocable trusts for the benefit of child and child’s siblings, naming child as trustee of child’s trust. Child has not made any contribution to the child’s irrevocable trust or the irrevocable trusts for child’s siblings. Trust terms specifically allow trustee to purchase and hold life insurance on the lives of trust beneficiaries, with trustee holding all rights to and incidents of ownership in the policy. Trustee has power to distribute income pursuant to an ascertainable standard for the benefit of child. On child’s death, child holds a special testamentary power of appointment among child’s descendants. Child holds the power to remove and replace the trustee. Trust includes a savings clause to protect inclusion of trust assets from inclusion in child’s gross estate prohibiting use of trust assets to satisfy any legal obligation of support owed by child, and makes provision for appointment of a special trustee, if needed, to make distributions to child’s descendants. Trustee’s intent to purchase a joint life insurance policy on the lives of trustee-child and child’s spouse caused the trust to apply for the private letter ruling.

The trustee petitioned the state court for an order modifying the terms of the trust as follows: (1) “if Trust owns any life insurance on the life of Settlor, a beneficiary, or a trustee, premium payments shall only be made out of corpus, and not out of income (as determined for federal income tax purposes under Subpart E of Part I, Subchapter J, Chapter 1, Subtitle A of the Internal Revenue Code []”); (2) a child who holds a special power of appointment may not exercise any power to appoint the life insurance policy or its proceeds; (3) the trust appoints a separate “insurance trustee,” one of child’s siblings, to hold, manage and distribute the life insurance policy to be purchased on child’s life, and further allows child to remove and replace the insurance trustee with a person not related or subordinate to child within the meaning of IRC Section 672(c).
In issuing the ruling, the Service cites Revenue Ruling 84-179, 1984-2 C.B. 195, and notes: “The ruling concludes that, based on the legislative history of § 2042(2), a decedent will not be considered to possess incidents of ownership in the insurance policy for purposes of § 2042(2), provided the decedent did not furnish consideration for maintaining the policy and could not exercise the powers for the decedent's personal benefit.” In issuing the ruling, the Service determines:

“The modifications to Trust relinquished Trustee's powers with respect to any life insurance policy on Child[]'s life acquired by Trust and granted such powers to an Insurance Trustee [and] precluded [trustee] from exercising any power normally conferred on the owner of a policy.

“Child[] retains a beneficial interest in income and principal of Trust, subject to an ascertainable standard. However, [] as modified, premium payments will only be made out of corpus and not income. In addition, Child[] has not made any contributions to Trust and further represents that Child[] will not make any contributions to Trust.

“Further, …as modified, Child[] may not exercise Child[]'s testamentary special power of appointment over any life insurance policies on the life of Child[]. Accordingly, Child[] may not exercise Child[]'s testamentary special power of appointment to change the beneficial interests in the proceeds of the life insurance policy on Child[]'s life.

On this basis the Service provides a favorable ruling, concluding:

“In this case, Child[]'s powers, in the capacity as Trustee and beneficiary were eliminated prior to the acquisition of the life insurance policy on Child[]’s life. Trust is the owner and beneficiary of the policy. Accordingly, when the Insurance Trustee purchased a life insurance policy on Child[]'s life, Child[] did not possess and did not have the power to exercise, any incidents of ownership in the policy acquired by Trust. Child[] will not relinquish or transfer any incidents of ownership in the policy as a result of the modification prior to the acquisition of the policy.

With careful drafting, the trust was able to isolate the child from the life insurance policy on child’s life by naming a separate Insurance Trustee. See also 201919003.
G.  Section 2055: Estate Tax Charitable Deduction

1.  Estate of Dieringer v. Commissioner, 2019-1 U.S.T.C. ¶60,710 (9th Cir. 2019), aff’g, 146 T.C. 117 (2016)

The Ninth Circuit affirmed the Tax Court’s 2016 decision in Estate of Dieringer v. Commissioner. In affirming, the Ninth Circuit relied principally on its earlier decision in Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cir. 1981). The Ninth Circuit in Ahmanson Foundation v. United States specifically held that the fair market value of assets owned by decedent at death may differ from the value for which a charitable deduction is allowed. At death, decedent in Ahmanson owned a controlling interest in HFA stock, and following death the stock was to be contributed to Ahmanco, with only non-voting stock in Ahmanco passing to the charity. The Ninth Circuit held the gross estate included the value of the HFA stock, valued as a controlling interest, and the charitable deduction valued with respect to the discounted value of the non-voting Ahmanco shares passing to charity. The court reasoned:

The statute does not ordain equal valuation as between an item in the gross estate and the same item under the charitable deduction. Instead, it states that the value of the charitable deduction "shall not exceed the value of the transferred property required to be included in the gross estate." 26 U.S.C. § 2055(d). Moreover, the statutory scheme specifically requires a lower valuation for the charitable deduction than for the same item within the gross estate under certain circumstances….In light of the purpose of the charitable deduction to encourage gifts to charity, it seems doubtful that Congress intended to give as great a charitable deduction when the testamentary plan diminishes the value of the charitable property as it would when the testamentary plan conveys the full value of the property to the charity intact.

Citing its decision in Ahmanson, the Ninth Circuit affirms the Tax Court in Estate of Dieringer v. Commissioner, which likewise held post-death events can impact the value of the charitable deduction and, in that instance, the charitable deduction is determined by the value of assets actually passing to charity, as opposed to the date of death fair market value of those assets.

The stock passing to the charity in Dieringer was included in the decedent’s gross estate at its undiscounted value, but thereafter the estate redeemed the stock passing to the charity based on a discounted redemption value in what the Ninth Circuit suggested was a questionable action with the same child in control of the estate, the trust and the charitable foundation. Testimony indicated the executor
specifically requested stock be valued at its discounted value for purposes of determining the redemption price, whereas it was included in the gross estate at its undiscounted value. As a result, the Ninth Circuit affirmed the Tax Court decision to limit the charitable deduction to the discounted value of the stock. Although the Ninth Circuit rested its holding on its earlier decision in Ahmanson Foundation v. United States, the Tax Court, citing treasury regulations, indicates: “if a trustee holds a power to divert the property to a non-charitable use that if directly bequeathed would not have qualified for the charitable deduction, only that portion of the property not subject to the trustee’s power qualifies for the deduction.” As explained in a footnote to it opinion, the Ninth Circuit chose not to address the regulation cited by the tax court.

2. **Private Letter Ruling 201930017 (July 26, 2019)**

Service Approves Formula for Determining Term of Years. In Private Letter Ruling 201930017 the Service addressed the use of a formula provision to determine the term of the charities lead interest in a CLAT. The formula defining the term provides:

Trust is to have a term, computed with respect to the date of Grantor's death, just sufficient to make the income interest in the trust for which a deduction would be allowed under § 2055 have an aggregate value of c percent of the aggregate fair market value of all amounts in the trust at its commencement. Upon the expiration of this term, the trustee is to distribute all trust principal to Grantor's children, the remainder beneficiaries.

The Service indicated it applied the formula to determine the date of termination indicating:

To determine whether the Trust will properly terminate under the terms of the Grantor's will, a termination date must be calculated under § 7520 so that the present value of the Charities' guaranteed annuity interest equals c percent of Trust's initial value. We performed calculations based upon our understanding of the trust mechanics as set forth above and basic actuarial and financial principles associated with the time value of money and the theory of interest. Our goal was to determine a termination date that would render the total present value of the charitable annuity to equal c percent of the initial trust value. In order to effect this, the final payment may need
to be a partial payment that occurs between two otherwise scheduled payment dates.

The ruling further determined that I.R.C. Section 507 would not apply to the CLAT to impose a tax on the termination of the trust term. It analogized:

Similar to § 53.4947-1(e)(2), Example (2), when Trust terminates on Termination Date, the provisions of § 4947(a)(2) will cease to apply because Trust no longer retains any amounts for which the deduction under § 2055 was allowed. Thus, the final payment to the remainder beneficiaries will not be considered a termination of the trust's private foundation status within the meaning of § 507(a).


In Private Letter Ruling 201933007 the Service addresses whether an estate tax charitable deduction will be allowed to the estate if, on donor’s death donor’s revocable trust pays to a QTIP for which an election will be made for the donor spouse’s lifetime or if not to a CLAT. The term of the CLAT is, like the ruling discussed above, determined by a formula:

The term of years and Termination Date of the CLAT is established by formula under Paragraph B(4) of Article II, as follows. Payment of the Annuity Amount terminates at the end of that number of years, rounded up to the nearest whole year, starting on the date of death of the survivor of Grantor and Spouse which, taking into account (i) the lowest federal mid-term rate which may be elected under § 7520; (ii) the frequency of the payment of the Annuity Amount; (iii) the Annuity Amount; and (iv) such valuation methods, tables, factors, and applicable rates prescribed by the appropriate provisions of the Code, results in a charitable deduction for federal estate tax purposes in the estate of the survivor of Grantor and Spouse equal to (or as close as possible to) one hundred percent (100%) of the fair market value of the property transferred to the CLAT as finally determined for estate tax purposes in the estate of the survivor of the of Grantor and Spouse.

The formula continues by directing trustee exactly what steps must be taken to determine the amounts ensuring a 5% annual payout:

Specifically, the trustee: (i) shall determine or obtain from the personal representative of the estate of the survivor of the Grantor and Spouse, the fair market value (Initial FMV) of the property transferred to the CLAT as
(ii) shall determine the Annuity Amount by multiplying the Initial FMV of the CLAT by the annual percentage payout rate of five percent (5%);

(iii) shall then divide the Initial FMV of the CLAT by the Annuity Amount;

(iv) shall determine the two term-of-years annuity factors between which fall the result determined in (iii) above, using the factors based on the applicable Treasury regulations or publications issued by the Internal Revenue Service using the applicable assumed rate of return prescribed by § 7520.

(v) The number of whole years for which the CLAT must be in effect in order to produce a charitable deduction in an amount that will be equal to or as close as possible to the fair market value of the property transferred to the CLAT as finally determined for federal estate tax purposes in the estate of the survivor of Grantor and Spouse, will be that number of years which corresponds to the greater of the two annuity factors determined in (iv) above. If the values used by the trustee in determining the Termination Date are incorrectly determined or if the Termination Date as determined is not correctly determined initially, then, within a reasonable time after the correct determination is made, the trustee shall lengthen or shorten the term of the CLAT to the correct duration.

The Service ruled that the formula satisfies the guaranteed annuity amount. It further ruled the estate of the survivor of the donor and donor’s spouse would receive a charitable deduction for the value of the lead interest to the charity.

Service Approves Reformation of Charitable Unitrust. In Private Letter Ruling 201947007 the Service rules a CRUT, upon reformation, meets requirements for a charitable deduction. The trust was reformed to provide benefits for a disabled beneficiary and at the same time qualify for a charitable deduction. Revenue Ruling 2002-20, 2002-1 C.B. 794, indicates that if unitrust amounts are paid to a separate trust other than the CRUT for the life of a financially disabled beneficiary, and on the beneficiary’s death assets of the separate trust are used to reimburse the state for Medicaid benefits, then pass to the financially disabled beneficiary’s estate or subject to the beneficiary’s general power of appointment, the trust may still qualify as a CRUT. The Service approved reformation of the
trust in this regard noting: (1) “The difference between the actuarial value of the qualified interest and the actuarial value of the reformable interest does not exceed 5 percent of the actuarial value of the reformable interest…” (2) “[T]he nonremainder interest (before and after the qualified reformation) terminates at the same time.” (3) “State Court issued an order approving the reformation of Trust and, pursuant to the order, the … reformation is effective as of the date of Decedent's death.”

H. Section 2056: Estate Tax Marital Deduction

1. Private Letter Ruling 201923004 (June 7, 2019)
   *Extension to Make QTIP Election Granted.* In Private Letter Ruling 201923004 the Service granted an extension of time to make a QTIP election where the attorney for the estate failed to correctly report property passing to the marital trust on Schedule M and to indicate the making of a QTIP election. See also Priv. Ltr. Rul. 201937011.

   *Extension to Make QTIP Election Granted a Nontaxable Estate.* In Private Letter Ruling 201943010 a nontaxable estate requested an extension to make a QTIP election. The estate’s accountant originally advised against on the basis of no portability election.

   *QTIP Election Ruled Void as to Credit Shelter Trust.* Private Letter Ruling 201943007 finds a QTIP election made with respect to a credit shelter trust that provided for distributions to both spouse and sister void. The ruling also grants an extension to make a severance and reverse QTIP election with respect to the other trust which did and should have qualified for the QTIP election.

I. Section 2056A: Qualified Domestic Trust

Private Letter Ruling 201928009 (July 12, 2019)
*Service Grants Extension to File Notice of Citizenship.* In Private Letter Ruling 201928009, the Service grants an extension to file notice of surviving spouse’s citizenship per Treasury Regulation 20.2056A-10(a). On filing such notice, the qualified domestic trust will no longer be subject to U.S. estate tax as imposed by I.R.C. § 2056A(b).
J. Sections 2207A and 2207B


Court Finds No Federal Jurisdiction to Enforce Recovery Where Executor Did Not Pay Tax Owed With Respect to Trust Assets Included in Gross Estate. The Eighth Circuit in a brief unpublished order held that where the estate has not paid tax with respect to trust assets, no jurisdiction lies for recovery of tax under I.R.C. Section 2207, 2207A or 2207B.

II. FEDERAL GIFT TAXATION

A. Section 2512: Valuation of Gifts


Wiseconsin Federal District Court Values Minority Interest Gifts in S-Corporation and Orders a Portion of Gift Tax Paid Refunded. Taxpayers gifted interests in a family-owned S-Corporation, Green Bay Packing, Inc. (GBP), that manufactures packaging products. The court notes the company is of a size that could be publicly traded, the Kress family continues to own 90% of the shares, with employees owning the remaining shares. An agreement covers purchase of employee stock and mandates a purchase price of 120% of book value per share. Stock owned by family members does not benefit from the purchase price agreement with employees. Restrictions on transfer apply to both employee and family shares, specifically, a right of first refusal. Additionally, per the bylaws, family members may only transfer shares to other family members. Taxpayers made minority gifts of stock to children in 2007, 2008 and 2009 and paid in the aggregate about $2.4 million in gift taxes.

During the time period involved, GBP indicated its intent to retain S-Corporation status, reporting S-statuts saved “a total of $238.4 million in taxes between 1988 and 2006…” The court noted GBP was a vertically integrated manufacturing company and owned three non-operating assets, an investment fund, life-insurance on key employees, and 2 aircraft.

Holding. The Court held for the taxpayer and found fair market value of the transferred stock shares to be: “$29.20 for tax year 2007, $27.01 for tax year 2008, and $22.50 for tax year 2009.” The Service had asserted substantially higher values based on those at which employee shares were subject to purchase of “$45.97 on December 31, 2006; $47.63 on December 31, 2007; and $50.85 on
December 31, 2008.” Given the difference in value, this was a significant win for the taxpayer.

**Burden Shifting.** The court shifts the burden of proof to the government under I.R.C. Section 7491 noting taxpayers “introduced credible evidence, including the testimony of two experts, to support their position, substantiated items, maintained records, and cooperated with the Government's reasonable requests.” The court emphasized, however, that shifting the burden proves significant “only … in the event of an evidentiary tie.” Citing Estate of Stuller v. United States, 55 F. Supp. 3d 1091, 1115 (C.D. Ill. 2014) (“"[I]f both parties have met their burdens of production by presenting some evidence, then the party supported by the weight of the evidence will prevail regardless of which party bore the initial burden of production or persuasion."”).

**Judicial Notice of Economic Outlook.** At the outset, the court took judicial notice of the poor economic outlook existing at the time of the gifts. Addressing the IRS objection, the court stated:

> The financial condition of the country in general and the stock market in particular as of the valuation dates is clearly relevant to the question of what price a willing buyer would pay for and a willing seller would sell a share of GBP stock on January 1, 2009. The Revenue Ruling governing the issue lists "the economic outlook in general and the condition and outlook of the specific industry in particular" as the second factor that a reasonable buyer and seller would normally consider. Rev. Rul. 59-60, 1959-1 C.B. 237 (1959). And while newspaper and online articles are not normally the kinds of evidence of which courts take judicial notice, a court may take judicial notice of a newspaper article if the movant demonstrates that "the facts of the article are either '(1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned'…

**Fair Market Value Determination and Treatment of Sub-S Status.** Turning to the valuation question, the court acknowledges: “The fair market value of non-publicly traded stock is generally determined by using one or a combination of the following: the market approach, the income approach, or the asset-based approach.” The government’s expert, Mr. Burns used a weighted average of the market approach, 60%, and the income approach, 40%. The taxpayer admitted two appraisals into evidences, one by Mr. Emory, who provided annual appraisals for the company, and one by Ms. Czaplinski, who provided the appraisal for
purposes of litigation. Mr. Emory used the market approach, modified to account for the income approach in certain respects. Ms Czapinski used a weighted average of the market approach, 14%, and the income approach, 86%. The court determined a fair market value based on Mr. Emory’s approach, indicating that his appraisal was not prepared in hindsight for litigation and did not suffer some of the same issues as the other appraisals, and preferencing comparable companies used by Mr. Emory, as well as, Mr. Emory’s consideration of economic outlook.

Notably all three experts tax-affected to reflect impact of sub-chapter S status. The court explained how each appraiser tax-affected to reflect sub-S status:

Burns – “Under the market approach….Burns derived a set of multiples by looking at enterprise value to earnings before interest, tax, depreciation, and amortization (EBITDA) and price to earnings and applied the multiples to the relevant GBP financial data. Burns applied an S-corporation tax premium to account for GBP's tax advantages as an S-corporation. He also added back the non-operating assets to reach an indicated value of GBP common stock.”

“Under the income approach, …[Burns] applied an effective tax rate to GBP as if it were a C-corporation and then applied an adjustment to reflect the value of GBP as an S-corporation.”

Emory -“After selecting the guideline companies, Emory derived multiples via the ratio of market value of invested capital to EBITDA, to account for GBP's subchapter S status, as well as multiples derived from earnings, dividends, sales, assets, and book value.”

Czapinski - “As to the market approach….Czapinski selected price-to-pre-tax-income as her multiple and used pre-tax income to capture the minority interest of the stock at issue, to capture the value of the non-operating assets, and to reflect GBP's subchapter S status.”

“Under the income approach….Czapinski adjusted the discount rate in the base cost to reflect an equivalent after-corporate and after-personal tax return.”

Upon considering the impact of sub-S statutes, the court concluded:

Both Emory and Burns applied C-corporation level taxes to GBP's earnings to effectively compare GBP to the other C-corporations. Burns
then assessed a premium to account for the tax advantages associated with subchapter S status, such as the elimination of a level of taxes, and noted GBP did not pay C-corporation taxes in any of the valuation years and did not expect to pay those taxes in the future. Emory and Czaplinski did not consider GBP's subchapter S status to be a benefit that would add value to a minority shareholder's stock because a minority shareholder cannot change GBP's corporation status. The court finds GBP's subchapter S status is a neutral consideration with respect to the valuation of its stock. Notwithstanding the tax advantages associated with subchapter S status, there are also noted disadvantages, including the limited ability to reinvest in the company and the limited access to credit markets. It is therefore unclear if a minority shareholder enjoys those benefits.

Application of I.R.C. Section 2703. The Government argues I.R.C. Section 2703 requires transfer restrictions on the family owned stock be disregarded for valuation purposes. The court agrees, but its analysis in arriving at such conclusion proves surprising in some respects. The court begins its analysis with the general proposition that “the valuation of any stock shall be determined without considering restrictions to sell the stock.” It then reviews the exception provided by I.R.C. Section 2703(b)(1) through (3) to determine if it applies to permit taking into account the restriction. The court finds it does not.

Pursuant to the exception, if the restriction:

(1) is a "bona fide business arrangement;" (2) is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (3) includes terms that are comparable to similar arrangements entered into by persons in an arms' length transaction

a determination of fair market value take the restriction into account. The court found the restriction a bona fide business arrangement noting the purpose to keep the company family owned, and distinguished the Tax Court’s decision in Holman v. Commissioner, 601 F.3d 763 (8th Cir. 2010), on the basis GBP was an active business. Somewhat surprisingly, the court determined that the second prong was satisfied because it applied only if the transfer was by a “decedent” rejecting the regulations softening of the words to mean a transfer to the “transferor’s bounty.” In dicta, the court found the second prong would be satisfied even if it applied to inter vivos transfers noting the restrictions were for the purpose of maintaining family control and not as a device. The third prong, however, caused the court to conclude the exception did not apply. The court
indicated taxpayer did not prove the third prong because it did not enter into
evidence examples of similar arm’s length provisions.

The court reduces the marketability discount by 3 percent to eliminate any impact
of the transfer restriction on value. The opinion specifically notes: “While
Emory also considered the Bylaw’s Family Restriction when applying discounts
for lack of marketability, he noted that the restriction did not have a significant
impact on the discounts.” The court agreed.

2. Estate of Jones v. Comm'r, T.C. Memo 2019-101

Tax Court Values Gifts of Limited Partnership Interests and Voting and Non-
Commissioner, the Tax Court rejected a more than $44 million deficiency
judgment and essentially adopted the taxpayer’s appraisal, prepared by Mr. Riley,
valuing the S-corporation voting shares at $390, the S-corporation non-voting
shares at $380 and the limited partnership interests at $380. (The taxpayer’s
appraisal differed from the values reported on the return of $325, $207 and $230,
respectively.) In contrast, the Service’s claimed fair market values were 3 to 5
times that of the taxpayer at $1,395, $1,325 and $2511, respectively. The Seneca
Sawmill Company (SSC), an S-corporation, operated the lumber mill. It
purchased almost 89% of the timber harvested by Seneca Jones Timber Company
(SJTC), the limited partnership operated by interlocking management with SSC as
controlling general partner. SSC actively planned and managed the timber
harvest of SJTC based on its needs and projections.

Valuation Methodology. The method used to value the timber company proved
the critical difference between the Service’s and taxpayer’s appraisals. The
Service’s appraiser used a net asset value approach to value SJTC on the basis it
was a non-operating natural resource holding company. The taxpayer’s appraiser,
in contrast, treated SJTC as an operating company giving weight to its earnings.
The taxpayer’s appraiser essentially treated SSC and SJTC as one operating
company and placed substantial weight on the income approach, using both a
discounted cash flow and a market approach. After noting SJTC had
characteristics of both an operating and a holding company, the court determined:
“Because it does not fit neatly into either category, a valuation that combines
consideration of SJTC’s earnings and assets and weights each appropriately may
be necessary, so we must dig deeper into the facts.” The weight given to the asset
approach by the court depended on the likelihood SJTC would sell its
timberlands. The court found that SCC, which had exclusive control of SJTC,
would never sell the timberlands given its reliance on timber supplied, and that
the limited partners were restricted from forcing a change in the decision. On that basis, it determined: “SJTC and SSC were so closely aligned and interdependent that, in valuing SJTC, it is appropriate to take into account its relationship with SSC and vice versa.” In doing so, it concluded: “an income-based approach, like Mr. Reilly's DCF [discounted cash flow] method, is more appropriate for SJTC than [the Service’s expert’s] NAV method valuation.

*Factual Issues.* The Service raised several subsidiary objections to Mr. Reilly’s appraisal of the stock and the limited partnership units including its: (1) reliance on revised projections; (2) “tax-affecting earnings before interest and taxes in projecting cash flow” for both SJTC and SCC, (3) treatment of SSC’s controlling interest in SJTC, (4) treatment of a loan between the two companies, and (5) the appropriate marketability discount. The court resolved these factual issues in favor of the taxpayer’s appraisal. It, however, found the issue of tax-affecting a legal issue and not a factual issue, finding the appraisers in agreement that tax-affecting was appropriate.

*Tax-Affecting.* The court outlined the methodology of the taxpayer’s appraiser used to account for the tax affect of operating as a limited partnership or as an S corporation as compared to a C corporation, when data used was based on publicly traded C corporations:

To do this he used 38% as a proxy for the combined Federal and State tax burdens that owners of SJTC would bear (treating SJTC in effect as a taxable C corporation, albeit at an individual, not corporate, tax rate), and adjusted both the earnings he used to calculate SJTC’s net cashflow and the cost of debt capital he used to determine the appropriate discount rate. He then computed the benefit of the dividend tax avoided by estimating the implied benefit for SJTC's partners in prior years and considering an empirical study analyzing S corporation acquisitions cited in his report. In his guideline publicly traded companies valuation, he used the tax-affected earnings as well, although the metrics he used to compare the companies to SJTC were pretax. Finally, he applied a 22% premium to SJTC's weighted business enterprise value (that is, his weighted DCF method and guideline publicly traded companies method valuations) to reflect that benefit.

The taxpayer’s appraiser tax-affected both by applying a downward adjustment in making the comparison and a premium to reflect tax benefits of operating as a pass-through tax entity.
In addressing the Service’s objection to tax-affecting, the court first notes the Service’s expert does not object to tax-affecting when using an income-approach. It then states: “Thus, we do not have a fight between valuation experts but a fight between lawyers.” The court reviews recent cases rejecting tax affecting and summarizes: “The question in those cases, as here, was not whether to take into account the tax benefits inuring to a flowthrough entity but how.” The court reined in the Service’s interpretation of its holdings in Gross v. Commissioner, T.C. Memo. 1999-254, and noted in other cases as well, while court’s may not have chosen to tax-affect for specific reasons, those courts nevertheless recognized the appropriateness of tax-affecting.


On Remand Tax Court Adjusts Gift Made on Merger of Company. In Cavallaro I, T.C. Memo. 2014-189, the Tax Court determined a disguised gift occurred when parents merged Knight Inc. with a newly formed corporation by sons. The father and son had developed a new product working with Knight’s engineers. As part of the merger, the sons took a greater ownership interest in the merged company than the parents, who had previously owned Knight. The Tax Court found Knight had owned the intellectual property rights to the new design, and as part of the merger the parents did not receive sufficient stock to compensate them for the intellectual property rights transferred with Knight. Taxpayers did not submit an appraisal and for that reason the court adopted the Service’s appraisal without addressing the taxpayer’s objections to the appraisal. On appeal, the First Circuit in Cavallaro II, 842 F.3d 16 (2016), affirmed the Tax Court on all issues except one. It remanded for the Tax Court to consider taxpayer’s objections the appraisal submitted by the Service was arbitrary and excessive. On remand, the Tax Court in the present case adjusted the gift value downward by $6.9 million on the basis that the profit margin used by the Service’s appraiser to calculate value was incorrect and should have been lower.

B. Section 2514: General Powers of Appointment

1. Private Letter Ruling 201920001 (released May 17, 2019)

Reformation of Trust Does not Cause Beneficiaries to Hold GPOA or Cause Lapse or Release of Power. In Private Letter Ruling 201920001, to correct a scrivener’s error, the trustee petitioned the court for reformation of trust to clarify beneficiaries did not hold a general power of appointment. The ruling indicates: “Several years after Grantor's death, the trustees became aware that Article III(b)(2) lacked the language necessary to prevent an appointment of trust
property to non-family members and that the broad language could be construed as granting a general power of appointment to the Beneficiaries. This would result in inclusion of trust property in each Beneficiary's gross estate. It is represented that such a result was contrary to Grantor's intent. On Date 3, Son 1, in his capacity as the trustee … petitioned Court to reform Trusts … to include the necessary limiting language to qualify each Beneficiary's power of appointment as a limited power of appointment, expressly prohibiting the appointment of trust assets to a Beneficiary, such Beneficiary's estate, the creditors of such beneficiary, and the creditors of such Beneficiary's estate.” The Service ruled the reformation would not cause inclusion of trust property in spouse grantor’s gross estate, the reformation made in accordance with the highest state court’s pronouncements does not cause beneficiaries to hold a general power of appointment or result in release of lapse of such a power, and ruled the deemed allocation rules will cause allocation of GST exemption to be made accordingly. See also Priv. Ltr. Ruls. 201920002, 201920003.

   a) Trust Ruled a Non-Grantor Trust, Transfers as Incomplete Gifts and Joint Powers Are Not General Powers of Appointment.

In a series of private letter rulings, the Service rules the trust is a non-grantor trust, transfers to the trust by grantor are incomplete gifts, exercise of powers by a distribution committee will not be treated as gifts by the members of the committee, and none of the Distribution committee members hold general powers of appointment. The rulings indicate the grantor will be deemed to make a gift at such time that there is a distribution from the trust to a permissible beneficiary other than grantor. These are typical consequences desired if what is being created is a NING, DING or trust of a similar acronym. The acronym stands for a “Nevada” or a “Delaware” “incomplete-gift non-grantor trust.” The facts typically indicate creation of an irrevocable trust for benefit of grantor and “permissible” beneficiaries, with a corporate trustee. The trustee makes distributions at the direction of a Distribution Committee to the “permissible” beneficiaries. The Distribution Committee acts by majority vote with consent of the Grantor, or may act by unanimous vote on its own. Grantor holds a nonfiduciary power to direct distribution to permissible beneficiaries other than grantor for a beneficiary’s maintenance, education, support or health. Distributions need not be equal. The distribution committee must at all times consist of at least two members, with successors in the order named, and the committee terminates on grantor’s death. At death, the grantor may direct
distribution to persons other than grantor’s estate or the creditors of the estate. This is termed a limited power of appointment, but in fact under the Code, powers retained by the grantor are not subject to taxation under IRC Section 2041 causing the terminology of the trust to be confusing. See Priv. Ltr. Ruls. 201908003, 201908004, 201908005, 201908006, 201908007. See also Priv. Ltr. Rul. 201925005, 201925006, 201925007, 201925008, 201925009, 201925010.

b) **Ruling Acknowledges that Community Property Transferred to a Trust May Receive a Stepped-Up Basis at Death.**
Private Letter Ruling 201852014 makes an additional ruling not addressed in the immediately preceding rulings addressing NINGs and DINGs. It addresses consequences on transfer of community property to a trust subject to exercise of jointly held powers by a distribution committee so that the transfer is protected from being treated as a completed gift and the trust is protected from being treated as a grantor trust. The ruling determines the property held in trust will receive a stepped up basis on the death of the first spouse to die.

c) **Ruling Acknowledges Trust May Receive a Charitable Deduction for Gift of Gross Income Per I.R.C. Section 642(c)(1).**
Private Letter Ruling 201908001 favorably rules that an incomplete gift nongrantor trust can obtain a charitable deduction for gifts of gross income. The Service reasons:

Section 642(c)(1) provides that in the case of an estate or trust, there shall be allowed as a deduction in computing its taxable deduction any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c), determined without regard to § 170(c)(2)(A). Section 1.642(c)-1(a)(1) of the Income Tax Regulations provides that any part of the gross income of a trust, which pursuant to the terms of the governing instrument, is paid during a taxable year for a charitable purpose shall be allowed as a deduction to the trust. Based on the facts submitted and representations made, except to the extent that Trust has unrelated business income within the meaning of § 681(a), Trust will be allowed a deduction in accordance with § 642(c)(1) for amounts of gross income paid during the taxable year (or by the close of the following taxable year).
elects) to a charitable organization by trustee pursuant to Article I(1) or Article I(2) of Trust; Settlor’s Inter Vivos Limited Power of Appointment in Article I(3) of Trust, and Settlor’s Testamentary Limited Power of Appointment in Article II of Trust.

Key to obtaining the ruling were representations that “Settlor has not claimed nor will she claim an income tax or gift tax charitable deduction under § 170(c) or 2522(a) for any property transferred by Settlor to Trust at any time, unless and until Trust makes a payment to one or more charitable organizations. No person (including any corporation or trust) other than Settlor is presently expected to make any transfer of property to Trust at any time, so no other charitable deduction will be claimed or available for contributions of property to Trust. Trust will not set aside any amounts for charitable purposes and claim a deduction under § 642(c)(2).”

C. **Section 2516: Certain Property Settlements**

**Private Letter Ruling 201901003 (Sept. 4, 2018)**

*Service Rules Transfer More Than Six Years Following Divorce Is Made for Full and Adequate Consideration.* Spouses divorce and less than 7 months later the court enters an order “putting into effect” the property settlement agreement of the spouses. The order sets forth the procedure for purchase of the property by one of the spouse’s from the other spouse. Following the repair of damages caused to the property from a neighboring home fire, pursuant to the terms of the order, as modified by the court to account for contributions made towards needed repairs caused by the unforeseen fire damage, one spouse purchased the property from the other spouse. Noting that the sale was made pursuant to the order effectuating the property settlement, and that the order was entered within one year of the divorce, the Service rules the transfer as between spouses is deemed made for full and adequate consideration, resulting in no gift. In addition the ruling also finds the transfer will not trigger gain per I.R.C. Section 1041.

D. **Section 2519: Disposition of Certain Life Estates**

**Private Letter Ruling 201946009 (Nov. 15, 2019)**

*Severance of Non-GST Exempt Marital Trust and Renunciation by Spouse of Interest in One of the Severed Trusts will Trigger I.R.C. Section 2519 as to that Trust Only.* In Private Letter Ruling 201946009, the trustee proposes to sever the Non-GST Marital Trust for which a QTIP election had been made. The spouse will renounce her interest in one of the severed trusts and thereby trigger I.R.C.
Section 2519, causing the spouse to be deemed to make a gift of her interest in the trust. The ruling also indicates the other severed trust will not be impacted by the renunciation.

III. GENERATION SKIPPING TRANSFER TAX

A. Section 2601: Modification of Grandfathered Trusts

Treasury regulations allow certain modifications to or trustee actions impacting a GST exempt trust without a loss of exempt status if the modification or trustee action does not shift a beneficial interest in the trust to a beneficiary occupying a lower generation than the person holding the beneficial interest prior to the modification.

1. Division into Separate Trusts.
   Pro-rata Division of Trusts Does Not Change Exempt Status. In Private Letter Ruling 201928004 the pro-rata division of trusts into separate trusts does not impact the GST exempt status of the trusts.

2. Termination of Trust Does Not Result in Imposition of GST Tax
   In Private Letter Ruling 201932005 a state court terminated a trust, ruling that the trust had no material purpose as son’s, the life beneficiary’s, wealth was such that son had no need of distribution for support. The Service ruled the early termination of the grandfathered trust would not trigger imposition of GST tax. The ruling further found no taxable gift by the beneficiaries and gain on termination will be characterized as long term capital gain.

   In Private Letter Ruling 201947003, the settlor and beneficiaries agreed to modify a trust to provide certain beneficiaries a general power of appointment and to revise successor trust provisions. The ruling indicates: “Under the proposed modification …the Trust property is divided upon Son's death into the same trust shares as under the original governing instrument of Trust. Each share will be held in a separate trust for the lifetime benefit of the beneficiary for whom it is created and any remaining trust property including undistributed income will be subject to that beneficiary's general power of appointment at his or her death.” Because the property subject to the general power of appointment will be subject to tax in the beneficiary’s gross estate, and the beneficiary will be treated as the transferor, the modification does not shift beneficiary interest to a lower generation beneficiary. The Service also ruled the modification will not trigger inclusion in the grantor’s gross estate under the “string” provisions, and no gift
will be deemed to occur. *See also* Priv. Ltr. Ruls. 201947006, 201947005, 201947004, 201947002, 201947001. *Compare* Priv. Ltr. Ruls. 201938006, 201938005, 201938004, where court construed trust to give beneficiary a general power of appointment to the same result.

**B. Section 2632: Special Rules for Allocation of GST Exemption**

1. **Extension to Elect Out of Automatic Allocation Rules**
   
   *Service Allows Extension to Elect Out of Automatic Allocation Rules.* The Code sets forth a series of automatic allocation rules for applying the GST exemption amount. If a taxpayer wishes to elect out of the automatic allocation, the taxpayer may do so on a timely filed gift tax return for the calendar year in which the election would become effective, see IRC § 2632(c)(5). The Service grants an extension in the following Private Letter Rulings 201944008, 201929005, 201927014; 201927015.

2. **Automatic Allocation Rules Apply**
   
   Service applies automatic allocation rules in private letter rulings 201925001, 201924015, 201925013.

**C. Section 2642: Generation Skipping Inclusion Ratio**

1. **Extension to Allocate Exemption**
   
   *Rulings Allow Extension to Allocate GST Tax Exemption.* It is advantageous to request an extension to allocate a transferor's GST exemption because the allocation can then be made based on the value of the property at the time of transfer, rather than at time of a "late" allocation of the exemption. Taxpayers may request the ruling pursuant to Notice 2001-50, and the relief will be granted upon a showing that the taxpayer acted reasonably and in good faith, and that the extension will not prejudice the interests of the government. The taxpayer acts reasonably and in good faith if she reasonably relies on the advice of a qualified tax professional. The extension may be sought both for elections under I.R.C. Sections 2632(b)(3) or (b)(5), and 2642(b)(1) or (2). The following is a list of rulings that allow the taxpayer an extension to allocate generation-skipping transfer tax exemption: Priv. Ltr. Ruls. 201942001, 201927013

2. **Taxpayer Substantially Complies with Notice of Allocation**
   
   *Service Acknowledges Substantial Compliance.* In *Private Letter Ruling 201936001*, the Service rules taxpayer substantially complied pursuant to 2642(g) despite the lawyer’s failure to attach a notice of allocation after making an election out of the automatic allocation rules. The Service found: “The information on the Form 709, in combination with the terms of Trust (a copy of
which was attached to the return), demonstrates Taxpayer's intent to allocate $a of his GST exemption to Trust and provides sufficient information to constitute substantial compliance.”

D.  **Section 2652: Reverse QTIP Election**

**Extensions Allowing Reverse QTIP Elections**

*Rulings Allow Extension to Make a Reverse QTIP Election.* The following is a list of rulings in which the Service grants an extension to make a reverse QTIP election, and in some instances, to sever a trust and allocate the other spouse’s GST exemption to one trust: Priv. Ltr. Ruls. 201942008, 201937011,

IV.  **ODDS AND ENDS**

A.  **I.R.C. Section 6402: Authority to Make Credits or Refunds**

*Chief Counsel Advice 201906006*

The Service, in a Chief Counsel Advice indicated a taxpayer could file for a protective claim for refund of gift tax. The letter indicated: “You asked whether protective refund claims can be made with respect to gift taxes. Exam recently denied such a claim because it stemmed from the gift tax. We conclude that protective refund claims can be made with respect to gift taxes. You found some materials that involve gift tax and protective refund claims. Similarly, we found a CCA that involves gift tax and protective refund claims. See CCA 200938021. There are IRM provisions that address protective refund claims, see e.g., IRM 21.5.3.4.7.3.1, and case law that goes beyond what's in the IRM, see CCA 201411021. In addition, the requirements for a protective refund claim were set out long ago in United States v. Kales, 314 U.S. 186 (1941).…. We have not found anything that specifically considers whether protective refund claims can be used for gift taxes and certainly nothing that excludes gift taxes from protective refund claims.

B.  **I.R.C. Section 2209: Certain Residents of Possession Considered Nonresidents**

*Private Letter Ruling 201924009*

Service rules that per I.R.C. § 2209 and Treasury Regulations 20.2209-1, taxpayer was treated as a nonresident not a citizen of the United States for purposes of federal gift and GST tax even though taxpayer was a naturalized citizen of the United States because citizenship was based solely on residence in a U.S. possession.
C. U.S. Supreme Court Kaestner Decision on State Income Taxation of Trusts


U.S. Supreme Court Kaestner Decision Rejects North Carolina Income Taxation of a Non-Grantor Trust Based on Residence of Beneficiary. Non-grantor trusts under the Internal Revenue Code are partial pass-through entities. To the extent distributions are made to beneficiaries, beneficiaries report those distributions, as appropriate, on their respective individual income tax returns. To the extent the trustee does not distribute trust income, the Internal Revenue Codes taxes that income to the trust. States also assert jurisdiction to tax non-grantor trusts in a similar fashion. Determination of a state’s taxing jurisdiction has become an important tax planning issue and one of some concern.

State statutes determining jurisdiction to tax non-grantor trusts vary. It is possible for more than one state to assert taxing jurisdiction over a non-grantor trust. Factors considered in asserting jurisdiction include settlor’s residence, the trust’s place of administration, and the residence of the trust beneficiaries. Overlapping factors can cause a trust to owe tax to multiple states.

The Kaestner decision addresses the constitutionality of North Carolina’s claimed jurisdiction to tax income of a non-grantor trust. North Carolina taxes the income of non-grantor trusts that “is for the benefit of” its residents. The Court begins by noting:

The North Carolina courts interpret this law to mean that a trust owes income tax to North Carolina whenever the trust’s beneficiaries live in the State, even if—as is the case here—those beneficiaries received no income from the trust in the relevant tax year, had no right to demand income from the trust in that year, and could not count on ever receiving income from the trust.

The opinion of the Court delivered by Justice Sotomayor, pointedly limits the opinion’s reach: “We hold that the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it.” 139 S.C. 2221. The reasoning of the Court, however, provides guidance beyond the facts of the Kaestner trust despite the effort to limit its application.

The facts indicate:
- Settlor was a New York resident.
- Named trustee is a New York resident. The trustee was not a resident of North Carolina.
- Trust designates New York as the governing state law.
- No trust assets or records were located in North Carolina.
- Beneficiary during the tax years in question was a North Carolina resident. Beneficiary was not a resident of North Carolina on the date the trust was created.
- Beneficiary held a discretionary income interest; in other words, trustee had sole or “exclusive” discretion to determine amount and timing of distributions, if any, to the beneficiary.
- Beneficiary’s remainder interest was contingent, requiring her to survive to age 40. Following the tax years in question, trustee “rolled over,” in the words of the Court, the trust assets “into a new trust” after conferring with the beneficiary.

The court resolves the issue of whether North Carolina’s statute violates the Due Process Clause of the Fourteenth Amendment, based on the following principles:

In the context of state taxation, the Due Process Clause limits States to imposing only taxes that “bear fiscal relation to protection, opportunities and benefits given by the state.” [Citations omitted.] The legitimacy of the power to tax requires drawing a line between taxation and mere unjustified “confiscation.” [Citation omitted.] The Court applies a two-step analysis to decide if a state tax abides by the Due Process Clause. First, and most relevant here, there must be “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.”’ Quill, 504 U. S., at 306, 112 S. Ct. 1904, 119 L. Ed. 2d 91. Second, “the ‘income attributed to the State for tax purposes must be rationally related to ‘values connected with the taxing State.”

Based on its prior holdings, the Court indicated it has determined the following meet the minimum connection necessary for a state to tax:

- In state residence of a trustee;
- In state administration of the trust;

139 S.Ct. at 2219-20. Citing its earlier decisions in Quill and in International Shoe, the Court explains “minimum connection” in terms of “minimum contacts” stating: “Ultimately, only those who derive “benefits and protection” from associating with a State should have obligations to the State.” Id. at 2220.
• Distribution of income to an in state resident beneficiary.

Justice Alito’s separate concurring opinion, in which Chief Justice Roberts and Justice Gorsuch joined, further noted the Court has decided the following:

• As to a “tangible asset” only the state of location “generally speaking” has the power to tax it;
• Despite a resident beneficiary’s right to and distribution of income from the trust, the state “could not impose taxes on the undistributed assets that remained within the trust” but were located elsewhere.

To determine if residence of a beneficiary is sufficient, citing prior decisions, the Court inquires whether the beneficiary has a “right to control, possess, enjoy, or receive trust assets.” Id. at 2221. It further indicates a similar inquiry applies to determine if the residence of a settlor or a trustee is sufficient. Control of trust assets by a resident settlor withstands the minimum connection analysis. Id. at 2222. A resident trustee’s legal ownership and control does, as well. Id. In applying the factors of control, possession, enjoyment or receipt of assets the Court finds the beneficiary of the Kaestner trust lacked ability to control distributions, to make investment decisions, and to assign the beneficiary’s interest in the trust. The direction to the trustee to distribute assets “liberally” was not enough to bring the beneficiary’s interest within the factors.

Notably, the Court rejects North Carolina’s argument that the Court’s holding will lead to “opportunistic game playing.” Of the ten states cited by North Carolina as ones considering the residence of the beneficiary, the Court in footnote 12 distinguishes the tax provisions of these other states from that of North Carolina. (This continues the Court’s theme of narrowing its holding.) Nevertheless, the footnote serves as a warning to states to consider a beneficiary’s residence only within the confines of minimum connections test. By its opinion, the Court has given greater shape to the parameters for determining the necessary minimum connection to tax.

D. Planning Considerations for Married Clients With Assets Fully Protected by Applicable Exclusion Amount (Excerpted from an outline prepared jointly with Professor James M. Delaney, University of Wyoming College of Law)

The advent of portability, in conjunction with an ever increasing BEA, has changed the estate planning landscape for couples whose wealth does not exceed the ever increasing BEA. For many taxpayers, the increased BEA, in combination with portability planning, yields no federal estate tax difference as between the choice to use an outright marital
gift, a QTIP trust or to use of a credit shelter trust. For that reason other factors take prominence in determining whether to employ a QTIP, credit shelter or other trust instead of an outright gift. In choosing an appropriate estate plan, those clients and their planners are more apt to consider:

- Client’s desire to control who receives the benefit of the gift and when it is received.
- Client’s desire to protect assets from the beneficiary’s creditors, including as a result of divorce.
- Client’s desire to minimize income tax on capital gains inherent in assets transferred.
- Client’s desire to obtain benefits of the generation-skipping transfer tax exemption.
- Client’s desire to minimize ongoing income tax costs.
- Client’s desire to minimize ongoing administration costs.

Not all factors can be achieved simultaneously. Trade-offs are required. Greater control may yield a higher tax bill and increased administration costs. Planning to minimize income tax results in less ability to exercise control over distributions. It is possible, however, to tweak estate planning choices to minimize disadvantages resulting from the particular choice. Achievement of client goals should consider impact of any applicable elective share rules and the possibility of future changes.

The following chart summarizes the ability of clients to achieve the listed planning goals when employing common types of marital gifts designed to use the BEAs of both spouses, assuming client elects portability when necessary. The comparison is as between outright gifts, QTIP trusts and traditional Credit Shelter Trusts. The Marital general power of appointment trust is not separately discussed as most of its advantages and disadvantages mirror the choice to make an outright gift.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Outright Gift to Survivor</th>
<th>QTIP Trust</th>
<th>Credit Shelter Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to control dispositive terms during surviving spouse’s lifetime</td>
<td>No</td>
<td>Some</td>
<td>Yes</td>
</tr>
<tr>
<td>Ability to control dispositive terms upon surviving spouse’s death</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

35
<table>
<thead>
<tr>
<th>Ability to obtain greater creditor protection for beneficiary</th>
<th>No</th>
<th>Yes, but</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yields second basis increase on death of survivor</td>
<td>Yes</td>
<td>Yes, in general</td>
<td>No</td>
</tr>
<tr>
<td>Allows for allocation of predeceased spouse’s GST exemption</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Ability to minimize ongoing income tax</td>
<td>Depends</td>
<td>Depends</td>
<td>Depends</td>
</tr>
<tr>
<td>Ability to avoid making portability election when return otherwise not required</td>
<td>No</td>
<td>No</td>
<td>Yes, if BEA fully used</td>
</tr>
<tr>
<td>Ability to minimize ongoing administration expense</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

**Key:**

- **“Clear Shading”** means: not required or not possible
- **“Light Shading”** means: possible to achieve, but with caveats
- **“Dark Shading”** means generally allowed or possible

Other options exist for obtaining a marital deduction, including the life estate with power of appointment trust provided under I.R.C. § 2056(b)(5). The trust must provide the surviving spouse a power of appointment to direct assets to herself, her estate or either, essentially giving the surviving spouse control of ultimate takers. The trust provides a vehicle for asset management not available with an outright gift.

When jointly representing a couple, as stressed in the comments to the professional rules, it is important to find commonality of planning goals. Given the new planning landscape, the tug of war is between one spouse preferring an outright gift, and the other placing higher priority on controlling transfer and use of property during the survivor’s life and at the survivor’s death. Other factors may move couples to a particular type of marital gift. For example, the types of marital gifts produce different outcomes if the client’s focus is achieving the possibility of a second step-up in basis at the survivor’s death – an outright marital gift and the QTIP trust prove better options than the credit shelter trust. Also, for example, if the client places emphasis on maximizing the ability to use each spouse’s available GST exemption, the QTIP trust would be the natural choice to achieve both the possibility of the second basis step-up and ability to allocate GST exemption of the first spouse to die. If an additional layer of creditor protection is desired during the survivor’s life, the balance likewise shifts to the QTIP trust. Consider approaching these issues during the client conference in a manner that narrows choices – first basis step up, second creditor protection, other tax considerations, and, finally, compare with client need to control. The need to control can often be resolved with careful choice and construction of trustee provisions. Given the advantages and disadvantages attached to each choice, document the client’s decisions.