CURRENT DEVELOPMENTS OF IMPORTANCE TO ESTATE PLANNERS

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Mr. Berry is a Life Member of the Uniform Law Commission and a Kentucky Delegate. He serves as Chair of the drafting Committee revising the Transfers to Minors Act and Vice-Chair of the drafting Committee on Conflicts of Laws in Trusts and Estates. He chaired drafting committees for the Uniform Fiduciary Income and Principal Act (UFIPA) and the Uniform Power of Appointment Act, Vice Chair of the Drafting Committee on Electronic Wills, Co-Chair of the Drafting Committee on Cohabitants' Economic Remedies Act, and as a member of the drafting committees for the Directed Trust Act, the Revised Fiduciary Access to Digital Assets Act, the Trust Decanting Act, the Insurable Interests in Trusts Act, the Premarital and Marital Agreements Act, the Transfer on Death Deeds Act, the Revised Disposition of Community Property Rights at Death Act, and the Uniform Probate Code Artificial Reproductive Technology provisions.

Mr. Berry is a Member of the Joint Editorial Board for Uniform Trust and Estate Acts. an elected Fellow of the American College of Tax Counsel, an elected member of the American Law Institute and of The International Academy of Estate and Trust Law. He serves as a member of the Advisory Council of the Heckerling Institute on Estate Planning, a Member of the Advisory Board of Trusts and Estates Monthly, and a member of the Bloomberg BNA Tax Advisory Board (Estates, Gifts, and Trusts). He serves as Adjunct Professor at the University of Miami Estate Planning LLM Program (teaching Business Succession Planning), and has served as Adjunct Professor at Vanderbilt University, the University of Missouri, and the University of Louisville, and regularly speaks at the nation's leading estate planning conferences. Since 1996, Mr. Berry has served as Co-Chair of the Midwest/Midsouth Estate Planning Institute at the University of Kentucky (the longest continuously run CLE event in Kentucky).

Mr. Berry has been certified as an Accredited Estate Planner® (AEP®) by the National Association of Estate Planners & Councils and is a member of its Estate Planning Hall of Fame [Kentucky does not recognize legal specialties]. He is listed in Woodward/White's The Best Lawyers in America® and in the Kentucky Super Lawyer Magazine in the area of Trusts and Estates.

Mr. Berry is the author or co-author of three Tax Management Portfolios: Estate Tax Deductions - Sections 2053 and 2054; Private Foundations - Self Dealing - Section 4941; and Taxable Expenditures - Section 4945. In addition his frequent articles have appeared in numerous journals and magazines. Mr. Berry received the Texas Bar Foundation Outstanding Law Review Article award for an article he co-authored with Paul Lee titled "Retaining, Sustaining and Obtaining Basis" which was published by the Texas Tech Estate Planning and Community Property Law Journal in January 2015

Mr. Berry has been an Articles Editor of The Tax Lawyer and a past chair of the Louisville Bar Association Probate and Estate Planning Section (1989 Section of the Year). He is a member of the Louisville Estate Planning Council, Kentuckiana Planned Giving Council, and an adjunct member of the American Association of Life Underwriters.
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Charles A. Redd is a partner in the St. Louis, Missouri, office of the law firm of STINSON LLP. Mr. Redd concentrates his practice in estate planning, estate and trust administration and estate and trust-related litigation. Prior to joining Stinson, Mr. Redd was a partner in and Vice Chairman of the Trusts & Estates Practice Group at the law firm of SNR Denton US LLP (now Dentons US LLP). Mr. Redd was also previously a partner in the law firm of Armstrong, Teasdale, Schlafly & Davis (now Armstrong Teasdale LLP) and was Chairman of that firm's Trusts & Estates Department. He was previously employed as a Trust Administrator by First Wisconsin Trust Company (now U.S. Bank, N.A.), Milwaukee, Wisconsin, and as an Assistant Counsel by Centerre Trust Company of St. Louis (now Bank of America Private Bank).

Mr. Redd has extensive experience and expertise in: (a) the drafting of wills, trust instruments, durable powers of attorney, marital agreements and other estate planning documents; (b) pre- and post-death tax planning for individuals, trusts and estates; (c) preparation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (d) representation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (e) representation of individual and corporate fiduciaries and (f) litigation in the Probate Division and other equity divisions of the Circuit Court. Mr. Redd has worked on estates and estate planning projects, some involving assets valued at over a billion dollars, and has successfully handled numerous estate tax, gift tax and generation-skipping transfer tax matters, will and trust construction cases, will contests, contests of trust agreements, alleged breach of fiduciary duty cases and other types of cases involving estates and trusts.

Mr. Redd is a member of the State Bar of Wisconsin, The Missouri Bar, the Illinois State Bar Association, The Bar Association of Metropolitan St. Louis and the Estate Planning Council of St. Louis.

Mr. Redd was Chairman of the Missouri Bar's Health Care Durable Power of Attorney Subcommittee, and he played a significant role in the drafting and enactment of the Missouri Durable Power of Attorney for Health Care Act. In 1991, Mr. Redd received The Missouri Bar President's Award. Mr. Redd was the principal draftsman of the Missouri Family Trust Company Act.

Mr. Redd is an elected member of The American Law Institute and a Fellow of The American College of Trust and Estate Counsel (Past Missouri State Chair; Past Regent; Estate and Gift Tax Committee; and Fiduciary Litigation Committee). He was an adjunct professor of law (Estate Planning) at Northwestern University School of Law for fifteen years. He serves as a member of the Advisory Committee for the Heckerling Institute on Estate Planning and is Co-Chair of the Editorial Advisory Board of, and writes a regular column in, TRUSTS & ESTATES magazine. In 2018, he was inducted into the Estate Planning Hall of Fame® by the National Association of Estate Planners and Councils and, in 2023, was named Distinguished Estate Planner of the Year by the Estate Planning Council of St. Louis. In 2024, Mr. Redd was identified among the top 100 lawyers in Missouri and Kansas by Missouri & Kansas Super Lawyers. Mr. Redd is listed in the 2025 edition of The Best Lawyers in America as the St. Louis "Lawyer of the Year" in "Litigation-Trusts and Estates," and is nationally "Band 1" ranked by Chambers and Partners in their High Net Worth guide. He frequently writes and lectures nationally on topics in the trusts and estates field.

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PART 1 – 2017 TAX ACT IS STILL MOSTLY WITH US AND WE HAVE A BIG – BEAUTIFUL/COLORFUL/CRAMMED WITH ODDITIES 2025 TAX ACT TOO

On December 22, 2017 was enacted "An Act To Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," Pub. L. No. 115-97, ("2017 Tax Act"). The 2017 Tax Act made significant income tax changes. The major transfer tax change was the doubling of the wealth transfer exclusion while continuing to index it with inflations. On July 4, 2025 the One Big Beautiful Tax Bill was signed which made many provisions from the 2017 Tax Act permanent, and created many other new provisions some of which are permanent but others that phase in and out over the next two election cycles. The 2025 act sets the transfer tax exclusion at $15 million on January 1, 2026, and adjusts it for inflation thereafter. Accordingly, the discussion of "clawback" and such would appear to be moot. Quite obviously, Congress could change these provisions at any time.

A. **Divorce – Income Tax**.

The 2017 Tax Act repealed section 682, which provided that if one spouse created a grantor trust for the benefit of the other spouse and the spouses divorced, thereafter the trust income would not be taxed to the grantor spouse to the extent of any income that the donee-spouse is entitled to receive. These changes are effective for divorce decrees and separation agreements entered into after 2018. Thus, taxpayers seeking a divorce during 2018 will likely benefit if the divorce is finalized before the end of the calendar year. Modifications entered into after 2018 are subject to the 2017 Tax Act if the modification expressly states that this provision of 2017 Tax Act applies. 2017 Tax Act § 11051(c)(2). No sunset applies to the repeal of the above provisions regarding alimony and separate maintenance payments and section 682. The IRS intends to issue regulations regarding the application of section 682 before its repeal is effective. Notice 2018-37. In the Notice, the IRS requested comments on whether guidance is needed regarding the application of sections 672(e)(1)(A), 674(d), and 677 following a divorce or separation in light of the repeal of section 682.

In light of the repeal of section 682, sections 672(e)(1)(A), 674(a) and 677(a) will have the effect of triggering grantor trust status due to the non-grantor spouse's powers over a trust even after the spouses divorce. Section 672(e)(1)(A) provides that the grantor of a trust shall be treated as holding any power or interest in such trust held by any individual who was the spouse of the grantor at the time of the creation of such power or interest. Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the trust assets is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. However, section 674(d) provides that section 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a Trustee or Trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, if such power is limited by a reasonably definite external standard that is set forth in the trust instrument. Section 677(a) provides that the grantor of a trust shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse, or held or accumulated for future distribution to the grantor or the grantor's spouse.

Of the many, many provisions of the 2025 act, a few are likely to be of direct interest to many estate planning clients. The SALT deduction is increased from $10,000 to $40,000 (plus 1% a year through 2029), but only for five years and with a phase-down that begins if your income is $500,000 or more. Several small changes were made to the income tax deduction for charitable contributions, including a $1000 per person above the line deduction, and a 1% floor on charitable contributions by corporations. The endowment tax on universities has been increased (top rate of 8%, on mega-endowed institutions)

Section 68 contains an "overall" limitation on itemized deductions. It now applies to trusts and estates. Beginning in tax years after December 31, 2025, it reduces the available deductions by 2/37ths of the lesser of the amount of itemized deductions and the amount at which the taxpayer is subject to the 37% rate. Absent regulatory relief, the scope of the 2/37ths cutback is extensive, including, for instance, itemized deductions allowed under section 67(e) for trustee fees and expenses, and the distributions deduction under sections 651 and 661.

In a nutshell, here is the problem. Section 62 defines adjusted gross income as gross income minus certain deductions. Those deductions do <u>not</u> include trustee fees or other expenses, nor section 651 or 661 deductions. Section 63(d) says deductions not described in section 63 or in calculating AGI are "itemized deductions." Section 67 lists itemized deductions and then 67(e) provides:

> (e) DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that—
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>> (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate, and
>>
>> (2) the deductions allowable under sections 642(b), 651, and 661, shall be treated as allowable in arriving at adjusted gross income. Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter to take into account the provisions of this section.

Note, the introductory clause limits the application to section 67. Accordingly, section 68 will limit all miscellaneous deductions which will include even the distribution deductions. Surely that was not intended.

However, Treas. Reg. § 1.67-4(a)(1)(ii) provides in part:

> Section 67(e) deductions are not itemized deductions under section 63(d) and are not miscellaneous itemized deductions under section 67(b).

Can a regulation under section 67 affect section 68? Yet, can't a taxpayer rely on the regulation until some change is made?

On the charitable front, section 642(c) seems also to be an itemized deduction, although it specifically states "without limitations." Does section 68 control because it is later, or section 642(c) because it is more particular? In addition, there is the 0.5% floor on itemized deductions which applies to trusts and estates, under section 170(b)(1)(I). The previous limits tied to the kind of assets given and to what kind of charity continue to apply as well. Section 170(b)(1)(c)(I) contains the following ordering rule which maximizes deductions:

1. Capital gain property to private nonoperating foundations (overall 20% AGI limitation).
2. Capital gain property to 50% charities (overall 30% AGI limitation).
3. Cash to 30% limit organizations (overall 30% AGI limitation).
4. Qualified conservation easements (overall 50% AGI limitation, but 100% in the case of a qualified farmer or rancher).
5. Noncash gifts to public charities (overall 50% AGI limitation).
6. Cash gifts to public charities (overall 60% AGI limitation).

Section 170(d)(i)(c) allows carryforwards of deductions disallowed by section 170(b)(1)(I).

PART 2 – IS MORE TAX REFORM ON THE WAY?

As of July 4, 2025, Republicans control the Presidency, the Senate, and the House. The margin of control is small. Whether "unified" government will continue after the 2026 election is uncertain. Budget deficits do not seem to be uncertain. When one or both sides conclude that must be increased we might expect a battle between those who want to add a value added tax, which is a broad consumption tax and thus must be constructed carefully to avoid being excessively regressive, and those who want to impose some form of wealth tax, which can be seen as a tax on non-consumption. Whether or not a wealth tax is constitutional, and whether or not a VAT can be implemented, attention may turn to (a) "loopholes" in the transfer tax regime, like grantor trusts and valuation discounts, and (b) the wide-spread basis step-up, with efforts to limit those in a quest for revenue and perhaps other goals. Income taxes on university endowment income and potentially foundation income may make novel taxes more palatable in the future.

Is a wealth tax constitutional? In Moore v. United States, 36 F.4th 930 (9th Cir. 2022), the Ninth Circuit held that the Sixteenth Amendment to the U.S. Constitution does not require that an income tax can only be applied to "realized income." In short form, as summarized by a dissent to the denial of a rehearing, the facts were:

> This case begins with a husband and wife's investment in an overseas company formed to empower small-scale farmers in impoverished regions of India. Charles and Kathleen Moore own a 13% stake in KisanKraft Machine Tools Private Limited, a small company headquartered in Bangalore, India. KisanKraft was formed in 2006 by Charles's friend and former coworker, Ravindra "Ravi" Kumar Agrawal, to import and distribute affordable farming equipment. Moved by Ravi's vision for helping farmers, the Moores invested $40,000 in KisanKraft and retained about 11% of the common shares in the company. Ravi and his wife moved to India to manage the company's day-to-day operations as approximately 80% owners.
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> Under Ravi's leadership, KisanKraft's revenues grew each year from 2006 to 2017. True to the original business plan, Ravi reinvested everything in the company. By 2017, KisanKraft employed over 300 people across 14 regional offices, distributing agricultural equipment to thousands of dealers. The Moores received updates and annual financial statements, but they never exercised any control over the company's earnings or operations, and never received any distributions, dividends, or other payments. They were content with supporting their friend's "noble purpose . . . to improve the lives of small and marginal farmers in India."
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> As the Moores would find out, no good deed goes unpunished. In 2018, they learned that under the Tax Cuts and Jobs Act of 2017, they were on the hook for their share of KisanKraft's lifetime earnings and would owe a one-time tax amounting to $14,729. This surprised the Moores, who had never received any income from KisanKraft and did not expect to pay income taxes just for owning a minority interest in the company. It's undisputed that the Moores did not realize income from KisanKraft and lacked the authority to compel a dividend payment constituting realized income. Not only are the Moores minority owners, KisanKraft does not have sufficient cash to distribute its retained and reinvested earnings. But nonetheless, under the Act, the Moores were liable for income tax on income they never earned.
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> This was thanks to the Mandatory Repatriation Tax [the MRT], a one-time "transition tax" to facilitate the repatriation of foreign earnings. *See* 26 U.S.C. § 965. The Mandatory Repatriation Tax targeted U.S. shareholders who held 10% or more in a "controlled foreign corporation"—a foreign entity with over 50% American ownership, *see* 26 U.S.C. § 967—that retained and reinvested its prior earnings overseas rather than distributing them to shareholders as dividends. *Moore*, 36 F.4th at 933. Previously, those shareholders would ordinarily only incur a tax liability when the foreign corporation distributes earnings and the shareholders repatriate those gains. *Id*. (citing 26 U.S.C. § 951 (2007)). But the Mandatory Repatriation Tax adopted a "novel" approach—it simply deemed the foreign corporation's retained earnings as the shareholders' "income" and taxed them according to their proportional ownership stake. *Id*. at 933–34.

The Moore's writ of certiorari was granted and oral argument was held on December 5, 2023. The Supreme Court affirmed the Ninth Circuit in an opinion written by Justice Kavanaugh and joined by Justices Roberts, Sotomayor, Kagan, and Jackson, with Barrett and Alito concurring in the judgment and Gorsuch and Thomas dissenting. In the majority's view, the opinion decided nothing interesting; in footnote 2, the majority writes:

> As discussed below, *infra*, at 22–24, our analysis today does not address the distinct issues that would be raised by (i) an attempt by Congress to tax both the

entity and the shareholders or partners on the entity's undistributed income; (ii) taxes on holdings, wealth, or net worth; or (iii) taxes on appreciation.

The majority reminds us of the background:

> Article I of the Constitution affords Congress broad "Power To lay and collect Taxes, Duties, Imposts and Excises." Art. I, §8, cl. 1. That power includes "'two great classes of'" taxes—direct taxes and indirect taxes. *Brushaber v. Union Pacific R. Co.*, 240 U. S. 1, 13 (1916).
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> Generally speaking, *direct* taxes are those taxes imposed on persons or property. *See National Federation of Independent Business v. Sebelius*, 567 U. S. 519, 570–571 (2012). As a practical matter, however, Congress has rarely enacted direct taxes because the Constitution requires that direct taxes be apportioned among the States. To be apportioned, direct taxes must be imposed "in Proportion to the Census of Enumeration." U. S. Const., Art. I, §9, cl. 4; see also §2, cl. 3. In other words, direct taxes must be apportioned among the States according to each State's population.
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> So if Congress imposed a property tax on every American homeowner, the citizens of a State with five percent of the population would pay five percent of the total property tax, even if the value of their combined property added up to only three percent of the total value of homes in the United States. To pay five percent, the tax rate on the citizens of that State would need to be substantially higher than the tax rate in a neighboring State with the same population but more valuable homes.
>
> To state the obvious, that kind of complicated and politically unpalatable result has made direct taxes difficult to enact. Indeed, the parties have cited no apportioned direct taxes in the current Internal Revenue Code, and it appears that Congress has not enacted an apportioned tax since the Civil War. See 12 Stat. 297; E. Jensen, The Taxing Power: A Reference Guide to the United States Constitution 89 (2005).
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> By contrast, *indirect* taxes are the familiar federal taxes imposed on activities or transactions. That category of taxes includes duties, imposts, and excise taxes, as well as income taxes. U. S. Const., Art. I, §8, cl. 1; Amdt. 16. Under the Constitution, indirect taxes must "be uniform throughout the United States." Art. I, §8, cl. 1. A "'tax is uniform when it operates with the same force and effect in every place where the subject of it is found.'" *United States v. Ptasynski*, 462 U. S. 74, 82 (1983).
>
> Because income taxes are indirect taxes, they are permitted under Article I, §8 without apportionment. As this Court has said, Article I, §8's grant of taxing power "is exhaustive," meaning that it could "never" reasonably be "questioned from the" Founding that it included the power "to lay and collect income taxes." Brushaber, 240 U. S., at 12–13. In 1861, Congress enacted the Nation's first unapportioned income tax. 12 Stat. 309. The Civil War income tax was recognized as an indirect tax "under the head of excises, duties and imposts." *Brushaber*, 240 U. S., at 15; see also *Springer v. United States*, 102 U. S. 586, 598, 602 (1881).
>
> In 1895, however, in *Pollock v. Farmers' Loan & Trust Co.*, this Court held that a tax on income from property equated to a tax on the property itself, and thus was a direct tax that had to be apportioned among the States. 158 U. S. 601, 627–628.

> The *Pollock* decision sparked significant confusion and controversy throughout the United States.
>
> Congress and the States responded to *Pollock* by approving a new constitutional amendment. Ratified in 1913, the Sixteenth Amendment rejected *Pollock*'s conflation of (i) income from property and (ii) the property itself. The Amendment provides: "The Congress shall have power to lay and collect taxes on incomes, *from whatever source derived*, without apportionment among the several States, and without regard to any census or enumeration." U. S. Const., Amdt. 16 (emphasis added).
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> Therefore, the Sixteenth Amendment expressly confirmed what had been the understanding of the Constitution before *Pollock*: Taxes on income—including taxes on income from property—are indirect taxes that need not be apportioned. *Brushaber,* 240 U. S., at 15, 18. Meanwhile, property taxes remain direct taxes that must be apportioned. See *Helvering v. Independent Life Ins. Co.*, 292 U. S. 371, 378–379 (1934).
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> What distinguishes income from property? The Moores argue that income requires realization. The Moores say that realization occurs when gains come into the taxpayer's coffers—for example, through wages, sales, or dividends, as distinct from appreciation in the value of a home, stock investment, or other property. And the Moores contend that the MRT does not tax any income that they have realized.
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> Critically, however, the MRT *does* tax realized income— namely, income realized by the corporation, KisanKraft. The MRT attributes the income of the corporation to the shareholders, and then taxes the shareholders (including the Moores) on their share of that undistributed corporate income.
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> So the precise and narrow question that the Court addresses today is whether Congress may attribute an entity's realized and undistributed income to the entity's shareholders or partners, and then tax the shareholders or partners on their portions of that income. This Court's longstanding precedents, reflected in and reinforced by Congress's longstanding practice, establish that the answer is yes.

The taxpayer relied on <u>Eisner v. Macomber</u>, a 1920 Supreme Court case, which the majority held was inapplicable:

> The Moores' reliance on *Eisner v. Macomber* with respect to the attribution issue is misplaced. Importantly, *Eisner v. Macomber* was *not* a case about Congress's power to attribute the income of an entity to the entity's shareholders or partners. Rather, the Court in *Eisner v. Macomber* addressed a situation where a corporation created and distributed additional stock to existing shareholders. 252 U. S., at 200. The corporation distributed the additional shares of stock in proportion to each shareholder's percentage of ownership. *Id*., at 210– 211. So the actual value of the shareholders' total stock holdings in the corporation did not change. *Ibid*.
>
> The question in *Eisner v. Macomber* was whether the new stock was nonetheless taxable income for the shareholders. *Id*., at 199. The Court said no. *Id*., at 212. The Court reasoned that there was no change in the value of the shareholders'

> total stock holdings in the corporation before and after the stock distribution. *Id*., at 210–211. So the new stock did not represent any kind of economic gain to the shareholders. *Ibid*. And the Court further stated that income requires realization. *Id*., at 207, 211–212. Yet neither the corporation nor the shareholders had realized income from the corporation's creation and distribution of additional stock. *Id*., at 210–213.
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> The Moores are obviously aware of those longstanding congressional practices and Supreme Court precedents, so they had two choices of how to deal with that stark reality in this Court. They could have argued that all of those taxes are unconstitutional and that all of those precedents should be overruled. Or in an effort to contain the blast radius of their legal theory, they could have tried to distinguish the MRT from those other taxes and argue that only the MRT is unconstitutional. They chose the latter approach.
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> To be specific: The Moores explicitly concede that partnership taxes, S-corporation taxes, and subpart F taxes are income taxes that are constitutional and need not be apportioned. Tr. of Oral Arg. 9, 48; Brief for Petitioners 50– 51. The Moores likewise do not ask the Court to overrule any of the precedents that we have discussed above, which upheld the attribution of entities' undistributed income. *Id*., at 49–52.
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> Instead, the Moores seek to differentiate the MRT from all of those other taxes long imposed by Congress and long upheld by this Court. The Moores have advanced an array of ad hoc distinctions to try to explain why those longstanding taxes are constitutional and why those precedents are correct, and to simultaneously try to explain why those taxes and precedents do not eviscerate their argument that the MRT is unconstitutional. But the Moores' effort to thread that needle, although inventive, is unavailing.
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> According to the Moores: (1) taxes on partnerships are distinguishable from the MRT and not controlled by precedent because partnerships are not separate entities from their partners; (2) taxes on S corporations are distinguishable from the MRT and not controlled by precedent because shareholders of S corporations choose to be taxed directly on corporate income; and (3) subpart F taxes on American shareholders' portions of undistributed foreign corporate income are distinguishable from the MRT and not controlled by precedent because those taxes apply what the Moores call "constructive realization."
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> To begin, and perhaps most importantly, the Moores' set of ad hoc distinctions does not undermine the clear rule established by this Court's precedents: Congress can choose either to tax the entity on its income or to tax the entity's shareholders or partners on their share of the entity's undistributed income. *Burk-Waggoner Oil Assn. v. Hopkins*, 269 U. S. 110, 114 (1925).

The real interest of tax advisors – and legislators – in Moore is whether realization must occur before there is income. The majority firmly punts! The opinion states:

> For their part, the dissent and the opinion concurring in the judgment focus primarily on the realization issue— namely, whether realization is required for an income tax. We do not decide that question today. When they reach the attribution question that we do decide, the separate opinions disagree with our reading of

> some of the Court's precedents. We respect their views. But as we thoroughly explained above, we read the Court's precedents differently.
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> That said, we emphasize that our holding today is narrow. It is limited to: (i) taxation of the shareholders of an entity, (ii) on the undistributed income realized by the entity, (iii) which has been attributed to the shareholders, (iv) when the entity itself has not been taxed on that income. In other words, our holding applies when Congress treats the entity as a pass-through.
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> To be clear, as we indicated earlier, the Due Process Clause proscribes arbitrary attribution. See *supra*, at 14, n. 4. And nothing in this opinion should be read to authorize any hypothetical congressional effort to tax both an entity and its shareholders or partners on the same undistributed income realized by the entity. In such a scenario, the entity would not simply be a traditional passthrough.
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> In addition, as the Government explains, other kinds of taxes could of course raise different issues. See Tr. of Oral Arg. 58–59, 62, 127–128. In its brief and at oral argument, for example, the Government indicated that a hypothetical unapportioned tax on an individual's holdings or property (for example, on one's wealth or net worth) might be considered a tax on property, not income. See Brief for United States 19 (distinguishing an income tax from a tax on wealth or net worth because "an income tax targets economic gain 'between two points of time'"); Tr. of Oral Arg. 69, 127–128.
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> And the Government further acknowledges that the constitutionality of a hypothetical unapportioned tax on appreciation may depend on, among other things, whether realization is a constitutional requirement for an income tax. See *id*., at 58–59, 62, 70, 93–95, 106–108, 126–127; see also Brief for United States 32. The Moores argue that realization is a constitutional requirement; the Government argues that it is not. To decide this case, we need not resolve that disagreement over realization. Those are potential issues for another day, and we do not address or resolve any of those issues here. As to the Moores' case, Congress has long taxed shareholders of an entity on the entity's undistributed income, and it did the same with the MRT. This Court has long upheld taxes of that kind, and we do the same today with the MRT. We affirm the judgment of the U. S. Court of Appeals for the Ninth Circuit.

Footnote 9 notes that some corporations are passthroughs and others are not and for those that aren't, it is perfectly fine for the corporation to be taxed on its income and for a shareholder to be taxed on dividends:

> That issue is distinct from Congress's well-established practice of taxing the corporation on corporate income and then taxing shareholders when they receive a dividend. See *Hellmich v. Hellman*, 276 U. S. 233, 237–238 (1928); see also *United States v. Hemme*, 476 U. S. 558, 572 (1986).

Justice Jackson wrote a brief concurrence arguing that almost any tax would be constitutional. Justice Barrett, with Justice Alito, wrote a concurrence emphasizing that there must be realization to have income. Appreciation cannot be income say these two. Here the corporation realized income so it can be taxed, via attribution.

Justice Thomas, with Justice Gorsuch, say who is kidding whom:

> The Moores are correct. Sixteenth Amendment "incomes" include only income realized by the taxpayer. The text and history of the Amendment make clear that it requires a distinction between "income" and the "source" from which that income is "derived." And, the only way to draw such a distinction is with a realization requirement. Our precedent says as much. In *Eisner v. Macomber*, 252 U. S. 189 (1920), the Court explained that "the characteristic and distinguishing attribute of income," as the term is used in the Sixteenth Amendment, is that it is "*received or drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal." *Id*., at 207. Because the Moores never actually received any of their investment gains, those unrealized gains could not be taxed as "income" under the Sixteenth Amendment.
>
> The Ninth Circuit wrongly rejected the Moores' challenge on the ground that "realization of income is not a constitutional requirement." 36 F. 4th 930, 936 (2022). That conclusion cannot be reconciled with the Sixteenth Amendment as the Court correctly interpreted it in *Macomber*. We therefore granted certiorari to answer the question "[w]hether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states," *i.e.*, as "incomes." Pet. for Cert. i.
>
> Today, the Court upholds the MRT only by ignoring the question presented. It does "not address the Government's argument that a gain need not be realized to constitute income under the Constitution." *Ante*, at 12–13, n. 3. Instead, the Court answers the question "whether Congress may attribute an entity's realized and undistributed income to the entity's shareholders or partners, and then tax the shareholders or partners on their portions of that income." Ante, at 8. After changing the subject, the majority upholds the MRT by relying on unrelated precedent to derive a "clear rule" that "Congress can attribute the undistributed income of an entity to the entity's shareholders or partners." *Ante*, at 10–11.
>
> I respectfully dissent. The Ninth Circuit erred by concluding that realization is not a constitutional requirement for income taxes. And, the majority's "attribution" doctrine is an unsupported invention.
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> In *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429 (1895), the Court considered whether the 1894 income tax was a direct tax that failed to satisfy the Direct Tax Clause's apportionment requirement. The taxpayer argued that portions of the tax were direct because "imposing a tax on the income or rents of real estate, imposes a tax upon the real estate itself." *Id*., at 555. And, taking the position that taxes on personal property are also direct taxes, the taxpayer argued that "imposing a tax on the . . . income of bonds or other personal property . . . imposes a tax on the personal estate itself." *Ibid*.
>
> The Court endeavored to determine what "were recognized as direct taxes" "at the time the Constitution was framed and adopted." *Id*., at 558. The Court considered historical context, the records of the Constitutional Convention, the Federalist Papers, other documents from the ratification debates, the 1794 carriage tax, and *Hylton's Case*. 157 U. S., at 558–568, 570–572. The Court concluded that "all taxes on real estate or personal property or the rents or income thereof were regarded as direct taxes" at the time the Constitution was ratified. *Id*., at 573–574. After reaching a conclusion about the original meaning of the Constitution,

the Court surveyed its precedents and observed that "in none of them is it determined that taxes on rents or income derived from land are not taxes on land," and that "none . . . discussed the question whether a tax on the income from personalty is equivalent to a tax on that personalty." *Id*., at 579. The Court had some difficulty explaining *Springer*, which stated that direct taxes are limited to capitation and land taxes and concluded that a tax on income was an indirect tax. *See supra*, at 15. But, the Court returned to "[t]he original record" in *Springer* to review the sources of the taxpayer's income, and it distinguished the case on that ground. 157 U. S., at 578–579.

In the end, the Court concluded that income could not be distinguished from the source from which it was derived for purposes of determining whether a tax on that income would be direct or indirect. It was "unable to perceive any ground" "upon which to rest the contention that real estate belongs to one of the two great classes of taxes," *i.e.*, the direct tax class, "and the rent or income which is the incident of its ownership belongs to the other," *i.e.*, the indirect-tax class. *Id*., at 581. It grounded that conclusion in the fact that the Direct Tax Clause was a federalism provision at the heart of the constitutional compromise: "If, by calling a tax indirect when it is essentially direct, the rule of protection could be frittered away, one of the great landmarks defining the boundary between the Nation and the States of which it is composed, would have disappeared, and with it one of the bulwarks of private rights and private property." *Id*., at 583.

The Court held that the Act was unconstitutional in part, "so far as it levies a tax on the rents or income of real estate." *Ibid*. But, the Justices divided evenly on the question whether the tax was unconstitutional "as to the income from personal property." *Id*., at 586. The case was therefore scheduled for rehearing.

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The Court relied on those federalism principles to reject the argument "that income is taxable irrespective of the source from whence it is derived." *Id*., at 629. It explained that the Constitution—read "in its plain and obvious sense" and in the context of "the circumstances attending the formation of the government"—could not be understood to treat income "as belonging to a totally different class" of taxation than the class "which includes the property from whence the income proceeds." *Id*., at 627–628. Such an interpretation would leave the Direct Tax Clause "utterly illusory and futile, and the object of its framers defeated." *Id*., at 628. The Court refused to allow the effect of the Direct Tax Clause to be "refined away by forced distinctions between" income and source. *Ibid*.

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The Sixteenth Amendment was designed to overrule *Pollock*'s obstacle to an income tax, and it was understood by the public in those terms. *Pollock* stood in some tension with the Civil War tax cases, and it was not well received. Critics likened it to *Dred Scott v. Sandford*, 19 How. 393 (1857), and the decision became a major issue in the 1896 Presidential election. Weisman 148. By the 1908 Presidential election, both major political parties supported finding a way, *Pollock* notwithstanding, to impose an income tax. See E. Seligman, The Income Tax 591–592 (2d ed. 1914).

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With a full understanding of the context against which the Sixteenth Amendment was ratified, two conclusions become clear. First, because the Amendment abolished *Pollock*'s rule that an income tax must be classified as direct or indirect based on whether a tax on the *source* of that income would be direct or indirect, the Amendment created a constitutional distinction between income and its source. Second, because Sixteenth Amendment "income" must be distinguished from its source, the Amendment includes a realization requirement.

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The word "income" in the Sixteenth Amendment must be interpreted in light of the Amendment's distinction between income and source. As the Court appreciated in *Eisner v. Macomber*, failure to understand "income" in this way leads to an interpretation of the Sixteenth Amendment that mistakenly displaces aspects of the original taxing provisions that the Amendment left in place: "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income.'" 252 U. S., at 206.

Without an understanding of "income" that distinguishes it from "source," the Sixteenth Amendment undermines the restriction imposed by the Direct Tax Clause. The Government asserts that the Sixteenth Amendment uses "'income' . . . to refer to all economic gains." Brief for United States 14 (some internal quotation marks omitted). That understanding of "income" would allow taxes on real and personal property without apportionment. To be sure, most of the Government's arguments focus on "taxes on individuals' pro rata shares of undistributed corporate earnings." *Id*., at 13. But, the Government is not shy about the fact that its definition of income includes things such as "increase in the value of a corporation's capital assets," "increase in the value of unsold property," and "appreciation in the value of securities." *Id*., at 16 (alterations and internal quotation marks omitted). Those increases are "income" in a purely economic sense, but not in a sense that meaningfully distinguishes between "income" and the "source" from which it is "derived." A tax on each, whether it be an increase in assets, unsold property, or securities, would be a tax on the value of real estate or property, and should therefore require apportionment under the Direct Tax Clause.

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In fact, the idea of realization as the distinction between income and source long predates both *Macomber* and the Sixteenth Amendment. As the Government acknowledges, "the concept" of "realization . . . was well established when the Amendment was adopted." Brief for United States 15. The term "*realized*" appeared in several Civil War income tax provisions. *Id*., at 16 (citing §116, 13 Stat. 281; §7, 16 Stat. 257–258). And, contemporaneous "[d]ictionaries defined 'realize' as 'to convert any kind of property into money.'" Brief for United States 15–16 (quoting Webster's 1778, and citing Black's Law Dictionary 993 (2d ed. 1910); alteration omitted). The Government argues that the decision to omit the often-used word "realized" from the Sixteenth Amendment is significant evidence that the Amendment does not require realization. See Brief for United States 16. But, the choice to instead use the near-synonym "derived" merely reflects the repeated use of the word "derive" to describe the relationship of income to its source in *Pollock*, to which the Sixteenth Amendment was a direct response. See 158 U. S., at 618, 629, 635.

The metaphor that the Court famously used in *Macomber* also shows the deep roots of the realization concept. To illustrate the "fundamental relation of 'capital' to 'income,'" *Macomber* compared "the former . . . to the tree or the land, [and] the latter to the fruit or crop." 252 U. S., 206. That understanding of income as being something "*severed from*" its source predated the Sixteenth Amendment. In a well cited case from 1878, the Georgia Supreme Court relied on a tree-and-fruit analogy in a tax case to explain the difference between income and property: "The fact is, property is a tree; income is the fruit." *Waring v. Mayor and Aldermen of Savannah*, 60 Ga. 93, 100 (1878); see also Black's Law Dictionary, at 612 (defining "income" (citing *Waring*, 60 Ga., at 99)).

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The majority separately concludes that the Moores' claim fails because they cannot distinguish the MRT from other longstanding taxes that they concede are constitutional. The majority sees no distinction between the MRT and older taxes on partnerships, "S corporations," and closely held foreign corporations under other parts of subpart F. *Ante*, at 16–21. But, the majority's insistence that the MRT is just like other forms of pass-through taxation is not convincing.

First, the MRT's taxation of corporate shareholders is not like pass-through taxation of partners. The Moores are correct that the Sixteenth Amendment allows Congress to tax partners on partnership income because "partnerships hav[e] no existence separate from their partners." Brief for Petitioners 51. A partner's share of partnership income is therefore understood to be his own income. The majority quibbles with the Moores' understanding of early-20th century partnership law and points out that "legislatures treated partnerships as separate entities in many contexts," including for some tax purposes. *Ante*, at 17–18. But, the fact that a partnership can sometimes be treated as an entity is beside the point. The significant fact is that partners had long been considered to be subject to income taxes without consideration of the partnership; longstanding taxes based on that understanding are not implicated by the Moores' challenge to the MRT.

Second, and for similar reasons, the MRT's taxation of corporate shareholders is not like pass-through taxation of shareholders of "S corporations." An S corporation is a corporation that does not have more than 100 shareholders, does not have any shareholder who is not an individual or who is a nonresident alien, does not have more than one class of stock, and which elects to be treated as an S corporation. 26 U. S. C. §§1361(a)(1), (b)(1). These eligibility requirements make it clear that pass-through taxation of S corporations is merely an extension of the pass-through taxation of partnerships. Indeed, for most tax purposes, S corporations are equivalent to partnerships, not to corporations. "Tax practitioners often say that an S corporation is taxed like a partnership." CCH S Corp. Guide ¶510, p. 505 (2013); see also West's Tax Law Dictionary (2024) (defining "S Corporation" as "Corporation which elects S status and receives tax treatment similar to a partnership"). Taxing S corporation shareholders on corporate income is constitutional for the same reasons as taxing partners on partnership income. To the majority, "S corporations are another example of Congress's authority to either tax the corporation itself on corporate income or attribute the undistributed income to the shareholders and tax the shareholders." Ante, at 19. But, it does not make sense to look to S corporations for conclusions about the pass-through taxation of corporate shareholders generally.

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The majority is not ashamed to lay bare the consequentialist heart of its opinion. Because it wrongly concludes that the Moores' constitutional argument would invalidate not only the MRT but also other longstanding taxes, the majority frets

> that the Moores would "deprive the U. S. Government and the American people of trillions in lost tax revenue" and "require Congress to either drastically cut critical national programs or significantly increase [other] taxes." *Ante*, at 21. "The Constitution does not require that fiscal calamity," the majority proclaims. *Ibid*. I agree. But, if Congress invites calamity by building the tax base on constitutional quicksand, "[t]he judicial Power" afforded to this Court does not include the power to fashion an emergency escape. Art. III, §1, cl. 1.
>
> Even as the majority admits to reasoning from fiscal consequences, it apparently believes that a generous application of dicta will guard against unconstitutional taxes in the future. The majority's analysis begins with a list of nonexistent taxes that the Court does not today bless, including a wealth tax. *Ante*, at 8, n. 2. And, it concludes by offering a narrow interpretation of its own holding, hinting at limiting doctrines, prejudging future taxes, cataloguing the Government's concessions, and reserving other questions "for another day." *Ante*, at 22–24. Sensing that upholding the MRT cedes additional ground to Congress, the majority arms itself with dicta to tell Congress "no" in the future. But, if the Court is not willing to uphold limitations on the taxing power in expensive cases, cheap dicta will make no difference.

The upshot of Moore is that four Justices would seem reluctant to uphold a wealth tax, but "seven reluctant" is not "would not" and among the Justices the two on the fence – Roberts and Kavanaugh – are inside the beltway folks. Also relevant to this discussion is Quinn v. State of Washington, 2023 WL 2620080 (Wa. 2023, en banc) in which the court held that the capital gains tax is appropriately characterized as an excise tax because it is levied on the sale or exchange of capital assets not on the assets or gains themselves. Washington has limits on property taxes which the plaintiffs argued this tax was.

An interesting facet of the plaintiff's argument was that excise taxes must be based on voluntary actions. The court disagreed:

> In Plaintiffs' view, the capital gains tax is not an excise because one owes the tax even in circumstances where the taxpayer does not "voluntarily" sell an asset, for example, where a trust sells capital assets on behalf of trust beneficiaries. To be sure, voluntariness is a distinctive feature of excise taxes, but Plaintiffs take too narrow a view. The State correctly notes that most transactions subject to this tax will have been voluntarily made by the taxpayer, and we are unpersuaded that the nature of the tax changes under the circumstances proffered by Plaintiffs, where the taxpayer does not personally undertake the transaction from which they realize a gain. Plaintiffs' logic falters when considered in the context of other taxes we have held to be valid excises based on voluntary transfers of property. For example, we unanimously upheld the estate tax as a valid excise though it is triggered by death— an event not usually associated with individual voluntary choice. *Hambleton*, 181Wn.2d at 831-33 ("taxing [qualified terminable interest property] assets upon the death of a surviving spouse qualifies as an excise tax"). And in the context of real estate transactions, a minority owner of property would still owe the real estate excise even if they personally objected to the majority owner's decision to sell jointly held property. "Voluntariness" in this context is best understood as pertaining to some action that results in a sale or transfer of property as the taxable event, whether or not reflecting the individual will of the taxpayer. That there may not be a personal, deliberate decision to engage in a transaction by the taxpayer in some situations does not transform this tax from an excise into a property tax.

PART 3 – ESTATE PLANNING PRACTICE IN 2023 AND BEYOND

I. WHERE WE ARE TODAY

A. New Planning Approaches

1. Given the large Applicable Exclusion Amount, it becomes clear that for many even traditional clients the estate tax has disappeared as an issue. This could change depending on political developments but does not appear likely to decrease in 2025. Many client couples are under $28 million but above $13,990,000.

2. Laying the groundwork today for future planning seems wise. The rules may not be as favorable always as they are today. Gifts into trusts with "trap doors" and flexibility seem wise. Both operated by fiduciaries may be safer than not, but in some instances a fiduciary might be unable to act. Unless an individual needs or wants a trust distribution, the individual need not be a trust beneficiary at any given moment. A sale to a trust for a note that can be forgiven should a gift become desirable may be an easy way to "get ready" while preserving flexibility.

3. Estate planners will focus more of the tax planning for clients on the income tax, rather than the transfer taxes. In particular, it is likely estate planning will focus on tax basis planning and maximizing the "step-up" in basis at death.

4. Because the "step-up" in basis may come at little or no transfer tax cost, estate planners will seek to force estate tax inclusion in the future.

5. The state of residence of the client and his or her beneficiaries will greatly affect the estate plan. In other words, if a client is domiciled in California, and his or her beneficiaries living in California, then dying with the assets may be the extent of the tax planning. On the other hand, if the beneficiaries live in a state like Texas that has no state income tax, then transferring the assets out of the estate during the lifetime of the client may be warranted. As a result, estate planners will need to ask clients two questions that, in the past, did not significantly matter: (a) Where are you likely to be domiciled at your death? and (b) Naturally, at your death, your children, grandchildren, and other beneficiaries will be lovingly at your bedside, but where are they likely to be domiciled then?

Another example of the importance of domicile can be seen in Shaffer v. Commissioner of Revenue, 148 N.E.3d 1197 (Ma. 2020), in which the first spouse to die did so domiciled in New York leaving a QTIP trust for the survivor who later died domiciled in Massachusetts in 2011. Massachusetts had an estate tax based on the size of the federal estate, which included the QTIP assets. The estate argued no Massachusetts QTIP election had been made but the court determined that was not relevant here. The estate also argued that the estate tax was unconstitutional when applied in this manner. The court concluded that the state could tax transfers of property rights and that the decedent's right in the QTIP transferred to the remainder beneficiaries at her death. The US Supreme Court declined to hear the case.

B. Portability Planning

1. Portability, at least in theory, can provide additional capacity for the surviving spouse's estate to benefit from a "step-up" in basis with little or no transfer tax costs. The extent to which portability is being used is uncertain. The 2017 IRS statistical data showed only 681 nontaxable portability returns filed.

2. In traditional by-pass trust planning, upon the death an individual who has a surviving spouse, assets of the estate equal in value to the decedent's unused Applicable Exclusion Amount fund a trust (typically for the benefit of the surviving spouse and, perhaps, descendants). The trust is structured to avoid estate tax inclusion at the surviving spouse's estate. The marital deduction portion is funded with any assets in excess of the unused Applicable Exclusion Amount. The by-pass trust avoids estate tax inclusion at the surviving spouse's estate. From an income tax standpoint, however, the assets in the by-pass trust do not receive a "step-up" in basis upon the death of the surviving spouse. Furthermore, while the assets remain in the by-pass trust, any undistributed taxable income above minimal amounts will be subject to the highest income tax rates at the trust level.

3. In portability planning, the decedent's estate would typically pass to the surviving spouse under the marital deduction, and the DSUE Amount would be added to the surviving spouse's Applicable Exclusion Amount. Because all of the assets passing from the decedent to the surviving spouse in addition to the spouse's own asset will be subject to estate taxes at his or her death, the assets will receive a "step-up" in basis. Additional income tax benefits might be achieved if the assets that would otherwise have funded the by-pass trust are taxed to the surviving spouse, possibly benefiting from being taxed a lower marginal income tax bracket. In addition, if the by-pass trust would have been subject to a high state income tax burden, having the assets taxed to a surviving spouse who moves to a low or no income tax state would provide additional income tax savings over traditional by-pass trust planning.

4. Of course, there are other considerations, including creditor protection, "next spouse" issues and potential "Medicaid" planning, which would favor by-pass trust planning. From a tax standpoint, the trade-off is the potential estate tax savings of traditional by-pass trust planning against the potential income tax savings of portability planning. Because the DSUE Amount does not grow with the cost-of-living index, very large estates will benefit more with traditional by-pass trust planning because all of the assets, including any appreciation after the decedent's death, will pass free of transfer taxes. On the other hand, smaller but still significant estates should consider portability as an option because the combined exclusions -- the DSUE Amount frozen but the surviving spouse's Applicable Exclusion Amount growing with the cost-of-living index -- is likely to allow the assets to pass at the surviving spouse's death with a full step-up in basis with little or no transfer tax costs (unless the assets are subject to significant state death taxes at that time).

Estates where a surviving spouse may need to qualify for government assistance should consider a modified by-pass trust type planning; the trust for the surviving spouse is designed specifically with governmental assistance in mind. For example, perhaps a child or other person should be allowed to terminate the spouse's interest in the trust (or otherwise modify it). Consider a trust "for" the surviving spouse in which the descendants are beneficiaries. A trusted child or other person could have a lifetime special power of appointment in favor of anyone; that power would be exercised every month, quarter, or year in favor of the spouse until that was inappropriate. The spouse would say accurately that no trusts were for his or her benefit. For Medicaid purposes, trusts under Will are favored over trust agreements.

5. In evaluating the income tax savings of portability planning, planners will want to consider that even for very large estates, the surviving spouse has the option of using the DSUE Amount by making a taxable gift to a grantor trust. The DSUE Amount is applied against a surviving spouse's taxable gift first before reducing the surviving spouse's Applicable Exclusion Amount (referred to as the basic exclusion amount). The grantor trust would provide the same estate tax benefits as the by-pass trust, but the assets would be taxed to the surviving spouse as a grantor trust thus allowing the trust assets to appreciate out of the surviving spouse's estate without being burdened by income taxes. If the assets appreciate, then this essentially solves the problem of the DSUE Amount being frozen in value. Moreover, the grantor trust likely provides for a power to exchange assets of equivalent value with the surviving spouse who can exchange high basis assets for low basis assets of the grantor trust prior to death and essentially effectuate a "step-up" in basis for the assets in the grantor trust.

6. Although a "step-up" in basis is great in theory, no tax will be saved if there is a loss at the time of death resulting in a "step-down" in basis or the asset is income in respect of a decedent (IRD). Furthermore, even if the assets receive a "step-up" in basis, will anyone benefit? Many assets, like family-owned businesses, may never be sold or may be sold so far in the future that the benefit of a step-up is attenuated. On the other hand, if the asset that receives a "step-up" in basis is either depreciable or depletable under the Code, the deductions that arise do result in tax benefits to the owners of that asset. Similarly, an increase in the tax basis of an interest in a partnership or in S corporation shares may not provide immediate tax benefits, but they do allow additional capacity of the partner or shareholder to receive tax free distributions from the entity. These concepts and how certain assets benefit or don't benefit from the basis adjustment at death are discussed in more detail below.

7. Portability planning is somewhat less appealing to couples in community property states because all community property gets a "step-up" in basis on the first spouse's death. Thus, the need for additional transfer tax exclusion in order to benefit from a subsequent "step-up" in basis is less crucial. This is not true, however, for assets that are depreciable (commercial real property) or depletable (mineral interests). As discussed below, these types of assets will receive a "step-up" in basis but over time, the basis of the asset will be reduced by the ongoing depreciation deductions. As such, even in community property states, if there are significant depreciable or depletable assets, portability should be considered.

C. <u>Other Considerations</u>

1. <u>Swapping Assets with Existing Grantor Trusts</u>. Many individuals have made significant taxable gifts, using all or a significant portion of their Applicable Exclusion Amounts. Many of those gifts were made

to grantor trusts. A common power used to achieve grantor trust status for the grantor trust is one described under section 675(4)(C), namely giving the grantor, the power, in a non-fiduciary capacity, to reacquire the trust corpus by substituting other property of an equivalent value. The trustee has a fiduciary duty to ensure the values are "equivalent" and that duty was noted in Revenue Ruling 2008-22. For income tax purposes, transactions between the grantor and the grantor trust will be disregarded, at least as of now. As such, grantors may exercise the power to swap high basis assets for low basis assets without jeopardizing the estate tax includability of the assets and without having a taxable transaction for income tax purposes. To maximize the benefits of the swap power, it must be exercised as assets appreciate or are sold over time. When exercised properly, this can ensure that only those assets that benefit the most from the step-up will be subject to estate inclusion.

If grantor does not have sufficient other assets, repurchase will be difficult - although the donor could borrow cash from a third party. What are the results if cash is borrowed by the grantor, the grantor buys assets from the trust, the trust loans the cash back to the grantor, the grantor pays back the third party lender and, at death, the grantor's estate satisfies the note to the trust with assets having fair market value basis? The income tax consequences if a note is used to repurchase property are uncertain because the trust's basis in note may equal grantor's original carryover basis in the asset given to the trust and now reacquired so paying off the note may generate gain. In other words, if grantor trust status terminates because the grantor dies, and the trust owns a note from the grantor – now the grantor's estate – the note likely does not receive a step-up in basis so when the estate pays it off the trust will have gain. Because the sudden or unexpected death of the grantor may make a repurchase difficult or impossible, estate planners may want to consider drafting "standby" purchase instruments to facilitate fast implementation of repurchase.

2. <u>Consider If Valuation Discounts Should Be Undone?</u> Where assets have been divided among generations to create discounts, consideration should be given to undoing those arrangements if the effect is to depress the value of an estate below the amount of Applicable Exemption Amount in order to increase the income tax basis of the assets. Discount entities could be dissolved or restated to allow the parties to the entity to withdraw. An option could be given to a parent allowing the sale of the parent's interest to a child or children for undiscounted fair market value at death. Giving such an option to a parent would be a gift unless accompanied by adequate and full consideration. If undivided interests in property are owned, agreements could be entered into that require all generations to consent to the sale of the property as one tract if any one owner wanted to sell. Quite obviously such agreements may be contrary to other estate planning or ownership goals of the family.

3. <u>Powers of Appointment For Basis Purposes</u>.

a. <u>Generally</u>. Consideration should be given to using a "circumscribed general power" that has the following characteristics: (1) a testamentary power, (2) in favor of the creditor of the powerholder's estate, (3) with the consent of a non-adverse party, (4) only over assets with a fair market value in excess of basis, and (5) capped such that the amount subject to the power when added to the other assets of the powerholder produces a total that is $1,000 less than the powerholder's Basic Exclusion Amount.

The rights of creditors to property over which a powerholder has a testamentary general power is worth considering. The majority view at common law is that the powerholder of a power, conferred on the powerholder by another, is treated as the beneficial owner of the appointive property for purposes of creditors' rights only if (1) the power is general *and* (2) the powerholder exercises the power. No distinction is made between a testamentary and a presently exercisable power. Creditors of a powerholder of a *non*general power, on the other hand, cannot reach the appointive assets even if the power was effectively exercised. The theory is that the donor who creates a nongeneral power did not intend to benefit the powerholder.

If the powerholder of a general power exercises the power by will, the view that the appointed property is treated as if it were owned by the powerholder means that the creditors of the powerholder's estate can reach the appointed property for the payment of their claims. See, e.g., Clapp v. Ingraham, 126 Mass. 200 (1879). The rule prevails even if this is contrary to the expressed wishes of the donor of the power. See, e.g., State Street Trust Co. v. Kissel, 19 N.E.2d 25 (Mass. 1939).

The exercise of the power by will does not confer actual beneficial ownership of the appointive assets on the powerholder for all purposes. The assets do not ordinarily become part of the powerholder's probate estate. Thus, in terms of priority, the powerholder's own estate assets are ordinarily used first to pay estate debts, so that the appointive assets are used only to the extent the powerholder's probate estate is insufficient.

Under the majority view at common law, the powerholder's creditors can reach the appointive assets only to the extent the powerholder's exercise was an *effective* exercise. A few states, however, follow the view that even an ineffective exercise entitles the powerholder's creditors to reach the appointive assets. See, e.g., Estate of Breault, 211 N.E.2d 424 (Ill. App. Ct. 1965). Moreover, even in states adhering to the majority view, an ineffective exercise can sometimes "capture" the appointive assets for the powerholder's estate, in which case the appointive assets become part of the powerholder's probate estate for all purposes, including creditors' rights.

When the powerholder of a general power makes an inter vivos appointment, treating the appointed assets as if they were owned by the powerholder does not automatically mean that the powerholder's creditors can subject the appointed assets to the payment of their claims. If the appointment is in favor of a *creditor*, the powerholder's other, unsatisfied creditors can reach the appointed assets only by having the appointment avoided as a "preference" in bankruptcy proceedings. Apart from bankruptcy, the powerholder can choose to pay one creditor rather than another with his or her owned assets, and the same is true with respect to appointive assets. If the appointment is in favor of a *volunteer* (i.e., the appointment is gratuitous), the powerholder's creditors can reach the appointed assets only if the transfer is the equivalent of a fraudulent transfer under applicable state law.

In a minority of jurisdictions, the powerholder of a general power, conferred on him or her by another, is *not* treated as the owner of the appointive property even if the power is exercised. See, e.g., St. Matthews Bank v. DeCharette, 83 S.W.2d 471 (Ky. 1935). Of course, if the powerholder exercises the power in favor of himself or herself or his or her estate, the appointed property becomes owned in the technical sense, and creditors even in states adhering to the minority view would be able to subject the assets to the payment of their claims to the same extent as other property owned beneficially by the powerholder. A few states have enacted legislation that affect the rights of the powerholder's creditors. The legislation is not uniform. Some of the legislation expands the rights of the powerholder's creditors and some narrows them.

The Uniform Powers of Appointment Act takes the following position. If the power is conferred by another, the rights of the powerholder's creditors depend on whether the power is general or nongeneral. If the power is general, the appointive property is subject to a claim of (1) a creditor of the powerholder, to the extent the powerholder's property is insufficient, if the power is presently exercisable (whether or not actually exercised), and (2) a creditor of the powerholder's estate, to the extent the estate is insufficient, subject to the right of a decedent to direct the source from which liabilities are paid. See Uniform Act §502. If the power is nongeneral, the general rule is that creditors have no rights in the appointive property. See Uniform Act §504(a). Some states (including Kentucky) have reversed this rule when adopting the act.

b. <u>Power of Appointment Not Subject to Fiduciary Standard.</u> In <u>In re Estate of Zucker</u>, 2015 WL 5254061 (Pa. Superior Ct. 2015), decedent's wife, Syma, exercised a power of appointment in favor of two of three children. The third, Wendy, objected claiming:

> Wendy alleged that Syma's appointment was not a proper exercise of the power as it was done "in bad faith, based on hate and malice toward Wendy, contrary to [the Decedent's] intent to benefit his issue equally (absent a good faith reason to the contrary) and the duty imposed on Syma to act in good faith when exercising a testamentary power imposed by Pennsylvania law."

The court disagreed, declining even to impose a good faith standard. The opinion states:

> We have reviewed the language contained in Decedent's will and in the codicil to Syma's will in which she directed that the principal contained in the marital trust be divided into two trusts for the benefit of Scott and Karyn and their issue. We have also reviewed the case law provided by the parties and the orphans' court. We conclude that none of the cases, in which challenges to the exercise of the power of appointment were raised, direct that the appointments must be made in good faith. Rather, we state again that a donee's duty is to the donor and the donee must exercise that power within the donor's established conditions. Moreover, the donee has the right to select some of the potential appointees to the exclusion of others. See Estate of Kohler, 344 A.2d at 472. No duty of good faith has been established. Therefore, we conclude that the orphans' court's grant of Scott and Karyn's motion for judgment on the pleadings was proper. The orphans' court did not commit an error of law.

The court notes that Syma was not the trustee. Does that matter? Suppose she had been; her exercise of a testamentary power of appointment would seem to occur after service as trustee ended. May a trustee exercise an inter vivos power without following a fiduciary standard?

The California Court of Appeals held in <u>Tubbs v. Berkowitz</u>, 47 Cal.App.5th 548 (Cal.App. 2020), that where a surviving spouse is named both as trustee of a marital trust and is given a lifetime general power of appointment over the marital trust assets, the surviving spouse could exercise the nonfiduciary power of appointment even while serving as trustee. The opinion states:

> A trustee "has a duty to administer the trust according to the trust instrument ...." (§ 16000.) A trustee also only has the powers conferred by the trust instrument and the powers conferred by statute, unless limited by the trust instrument. (§ 16200.) Here, the very language of the Marital Trust allowed Berkowitz to act in his capacity as the surviving spouse (not the trustee) and designate himself as the recipient of the Trust assets. The Marital Trust then required the trustee to distribute the assets to any person designated by the surviving spouse, including the surviving spouse himself. Thus, under the plain terms of the Marital Trust, Berkowitz (acting as the trustee) was required to transfer the assets once he exercised the power of appointment in his favor. He could not possibly have breached any fiduciary duties by doing something that was expressly authorized and required under the terms of the Marital Trust. (*Hearst v. Ganzi* (2006) 145 Cal.App.4th 1195, 1207-1208, 52 Cal.Rptr.3d 473 [trustees did not breach their fiduciary duties where their actions were explicitly authorized by the trust].)
>
> Finally, we note that Berkowitz's exercise of his power of appointment would have been unobjectionable if he had resigned as trustee before exercising the power. In that scenario, the successor trustee (Tubbs) would have been required to transfer the assets to Berkowitz once he exercised the power of appointment in his favor. Tubbs claims "those are not the facts before this Court," but we see no reason why the result should be different where Berkowitz was both the donee and the trustee who had no discretion but to follow the terms of the power of appointment.

No authority is cited on the point (either way).

To the contrary is Peterson v. Peterson, 835 S.E.2d 651 (Ga. App. 2019), a much litigated matter whose facts were described as follows:

> Charles Hugh Peterson died testate in 1994 and was survived by his wife, Mary, and their three sons Alex, David, and Calhoun. Mr. Peterson's will, which was probated in 1995, created two testamentary trusts: a marital trust for the primary benefit of Mary, and a residual "by-pass" trust for the benefit of Mary and the couple's three sons. Mary and her three sons were each designated a co-executor of the will and a co-trustee of both the marital and by-pass trusts. Item 5 of Mr. Peterson's will created a marital trust for Mary, while Item 6 created a by-pass trust for Mary and their three sons. The relevant portion of the will creating the terms of the by-pass trust reads as follows:
>
>> Trustees shall hold and manage the property in this trust and ... may encroach on such part of the principal thereof as the Trustees may deem necessary to provide for the support in reasonable comfort of my wife and to provide for the proper support and education of my descendants[.] To the extent practicable, however, I request the Trustees in making encroachment for the benefit of my wife to encroach first on any trust created for my wife ... before encroaching on this trust for my wife[.]
>>
>> My primary desire is that my wife be supported in reasonable comfort during her lifetime and that my children be supported in reasonable comfort during their lives; my secondary desire is that the principal of

> this trust be preserved as well as possible consonant with the consummation of my primary objective[.]
>
> [My wife] shall have no power to appoint [trust] property to herself, to her estate, to her creditors, or to the creditors of her estate.
>
> * * *
>
> Sometime after the will was probated, a dispute arose between the co-executors and co-trustees over the administration of the estate and the by-pass trust, pitting Mary and Calhoun against Alex and David. Alex and David filed petitions for accounting and damages for breach of duties as executors and trustees against Mary and Calhoun, and sought the removal of Mary and Calhoun as executors and trustees in probate court. Mary and Calhoun each moved for summary judgment on all claims, and the superior court granted their motions. Alex and David appealed those rulings.
>
> In the first appearance of this case before this Court, we reversed the trial court's grant of summary judgment to Calhoun in an unpublished opinion. See *Peterson I*. One month later, the Supreme Court of Georgia in *Peterson II* reversed the trial court's grant of summary judgment to Mary for similar reasons. Both cases held that material issues of fact remained with respect to Appellees' failure to fully fund the trusts at issue in the case and whether Appellees wasted assets. See *Peterson I*, slip op. at pp. 7-8, 10; *Peterson II*, 303 Ga. at 215-217 (3), 811 S.E.2d 309.

The trial court had held that Mary did not owe the other beneficiaries a fiduciary duty when exercising the power of appointment. Mary cited a Connecticut case, <u>Connecticut Bank & Trust Co. v. Lyman</u>, 170 A.2d 130 (Conn. 1961) but the Georgia court noted in <u>Lyman</u> the powerholder was not a trustee. The Georgia Court of Appeals went the other way, deciding Mary <u>did</u> have a fiduciary duty:

> In the present case, the potentiality of conflicts of interests with respect to Mary's requests for conveyance of all property in the by-pass trust to Calhoun is well documented in the litany of litigation that has transcended decades among the co-trustees and co-beneficiaries. As we find no law which could excuse Mary from her fiduciary duty under the trust, even if acting solely as a beneficiary under the trust, we find that the trial court erred in concluding that Mary could act exclusively in her capacity as a beneficiary of both trusts in exercising her appointment power to convey trust assets.

In <u>In re Trust Under Deed of Trust of Neil G. Jack, Settlor</u>, 284 A.3d 451 (Sup. Ct. Pa. 2022), the Pennsylvania Superior Court reversed the Orphans' Court and held that a trustee could exercise a power of appointment. The opinion states:

> "A power of appointment is a power that enables the donee of the power to designate recipients of beneficial ownership interests in[,] or powers of appointment over[,] the appointive property." Restatement (Third) of Property (Wills & Don. Trans.) § 17.1 (2011); ***accord*** 20 Pa.C.S.A. § 7703, cmt. "In exercising the power, the donee must observe strictly its provisions and limitations." *Estate of duPont*, 475 Pa. 49, 379 A.2d 570, 571 (1977), quoting *Rogers' Estate*, 218 Pa. 431, 67 A. 762, 762 (1907). A donee's duty is to the donor and the donee must exercise the power within the donor's established

> conditions. *In re Estate of Zucker*, 122 A.3d 1112, 1117 (Pa. Super. 2015). The holder of a power of appointment is a beneficiary of a trust, and not a trustee or other fiduciary, and is not bound by a duty of good faith. *Id.* at 1116-17. Where the language of the document so provides, a donee may select some of the potential appointees to the exclusion of the others. *Id.* at 1117. Put another way, in exercising a power of appointment, the donee is limited only by the terms of the document under which the power was granted.
>
> Here, Article I, Section 2.2 of the Trust ("Special Power of Appointment") provides as follows:
>
>> During the lifetime of Christine [ ] or upon her death, the Trustees shall distribute the Trust Estate to or for the benefit of such one or more of the issue of Christine [ ] as Christine [ ] may appoint by specific reference in a deed or in her will to this power; provided, however, that Christine [ ] shall have no authority hereunder to discharge any legal obligation she may have.
>
> Irrevocable Trust of Nell G. Jack, 5/29/81, at Article I, § 2.2. By using the clause "such one or more," Settlor granted Christine an exclusionary power of appointment, allowing her to select, in her discretion, amongst the potential appointees. Her power is limited only by the prohibition against using the power of appointment to discharge a legal obligation. Because Christine holds an exclusionary power of appointment in her individual capacity and is not bound by duty of good faith in her exercise of that power, *see In re Estate of Zucker*, *supra*, the Orphans' Court erred by issuing an injunction limiting her exercise of the power based on allegations regarding her conduct as a fiduciary.

We often do not think of powerholders as trust beneficiaries. The court must not have been disturbed by the two hats worn by Christine, one fiduciary and one not, because the opinion does not discuss any potential conflict.

Because the holder of a power of appointment is not a fiduciary, the holder of a lifetime power may have his or her actions attributed to a grantor or beneficiary. In the 1970s two cases dealing with the Goodwyn family established the principle that if a trust agreement prohibited the grantor from acting as de facto trustee the mere fact that the grantor did in fact act as de facto trustee would not established a retained interest under section 2036, <u>Estate of Goodwyn</u>, T. C. Memo. 1973-153, nor a power for the grantor trust provisions of sections 671ff, <u>Estate of Goodwyn v. Commissioner</u>, T.C. Memo. 1976-238:

> Under the terms of the deeds creating these trusts, the trustees were granted broad discretionary powers with respect to both the distribution of income to the beneficiaries and the investment and management of the corpus of the trusts. Notwithstanding the designation of Richards and Russell as trustees, it further appears that at all times from the establishment of the trusts until his last illness, the decedent exercised complete control with respect to the purchase and sale of trust assets, investment of any proceeds, and the determination of the amounts, if any, to be distributed to the respective beneficiaries.
>
> The assets of the various trusts, together with other trusts, as well as property owned by the decedent, were accounted for by a single set of records maintained in the offices of the decedent. Except for the Federal income tax returns prepared and filed by the decedent on behalf of the various trusts, no separate records were maintained showing the assets and income of any of these trusts.

> The respondent argues that the decedent should be treated as trustee, in fact, possessing such rights and powers as to cause the inclusion of the assets thereof in his gross estate, relying on sections 2033, 2036 (a)(2), and 2038. Section 2033 requires a finding that the decedent had an interest in the assets of the trusts at the time of his death. There is no basis for such a finding. Section 2038(a)(1) relates to "a power" exercisable by the decedent "to alter, amend, revoke, or terminate," the trusts. No such power was reserved by the decedent. Accordingly, in the final analysis the respondent's position is predicated on the determination that by reason of the de facto control exercised by the decedent the trusts are includable in his estate pursuant to section 2036(a)(2).[5] It is clear that the powers granted to the trustees would, if reserved by the decedent, be such as to require the inclusion of the assets of the trusts in the estate of the decedent. *United States v. O'Malley* [66-1 USTC ¶ 12,388], 383 U.S. 627 (1966). Does the fact that the decedent was able to exercise such powers through the cooperation of unrelated trustees require a different result? The question thus presented for decision is whether the value of such trusts is includable in the estate of the decedent by reason of the de facto control over the trusts exercised by the decedent, notwithstanding that no power to exercise such control was reserved to or by the decedent once he resigned his duties as trustee of certain of these trusts.

[footnotes omitted]

The Goodwyn rationales appear to be based on a trustee having authority; if an advisor who is not a fiduciary can direct a trustee, and the trustee must follow the direction, then will Goodwyn protect the grantor whose advisor follows the grantor's advice regularly? Similarly, where a grantor gives an inter vivos power of appointment to someone during the grantor's lifetime the Goodwyn rationale is inapplicable?

PART 4 – FEDERAL RULINGS, CASES AND OTHER DEVELOPMENTS

A. INCOME TAX MATTERS

1. Consistent Basis Reporting. Section 2004 of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, enacted on July 31, 2015, created new "consistent basis" requirements under the Code. Suppose an executor values an asset at 100, distributes the asset to a beneficiary who believes the value on the decedent's date of death was really 120 so when the beneficiary sells the asset for 120 the beneficiary reports no gain. To combat this situation – which will often, although not always, be abusive -- new section 1014(f) requires that an estate and the recipient of assets from the estate adhere to consistent basis between them, which in practice means that the recipient must adhere to the basis adopted (or agreed to in a tax audit) by the estate. That aspect of the legislation and its implementation is generally non-controversial. However, in addition section 6035 requires the reporting of basis among subsequent transferees (e.g. trustees and beneficiaries), which is much more controversial. Proposed Regulations were issued in March, 2016 (REG-127923-15) and Final Regulations were issued on September 17, 2024 (TD 9991).

One issue that Treasury acknowledged it has not addressed is how might a beneficiary challenge a determination by an executor. In other words, suppose an executor settles an estate audit with the IRS by increasing the value of an asset passing to the executor and reducing the value of an asset passing to the beneficiary. If the estate tax is paid from the residue, the effect will be to reduce future income tax when the executor sells versus when the executor sells. The Summary recognizes the problem and notes it is being considered, but they don't have a good solution as yet. State law may provide a remedy but such an action is likely to be cumbersome.

Among the most controversial and surprising provisions of the Proposed Regulations was the zero basis rule. The Final Regulations eliminated the rule, perhaps because Treasury lacked statutory authority to issue it. The Proposed Regulations provided that if an executor reports after-discovered or unreported property on an estate tax return that is filed before the expiration of the period of limitations on assessment of the estate tax, then the final value of the property is determined under the normal rules of the Proposed Regulations. However, if the unreported property is not reported before the period of limitations on assessment expires then the final value of that property is deemed to be zero. And, if no estate tax return was filed, proposed §1.1014-10(c)(3)(ii) provided that the final value of all property includible in the gross estate subject to the consistent basis requirement is zero until the final value is determined under proposed §1.1014-10(c)(1) or (2). Because the application of proposed §1.1014-10(c)(3)(i)(B) or §1.1014-10(c)(3)(ii) results in the beneficiary having an initial basis of zero in unreported property, these proposed provisions were collectively referred to as the zero basis rule.

In issuing the Final Regulations, Treasury rejected the notion that it lacked authority to issue the rule, but decided to scrap it anyway. The Summary states:

> However, the Treasury Department and the IRS recognize that such a rule primarily impacts the recipients of unreported property, who may have had no knowledge of or involvement in the failure to report the property for Federal estate tax purposes, but, nevertheless, have an increased tax burden under the rule.
>
> The Treasury Department and the IRS additionally recognize that, under applicable State law, an executor is personally accountable to discharge its fiduciary duty to seek out and collect every asset and to acquire possession of the property of the decedent. See 31 Am. Jur. 2d *Executors and Administrators* § 369 (2018); *Eger v. Eger*, 314 N.E.2d 394 (Ohio App. 1974); *Matter of Deutsch*, 114 A.D.2d 413, 493 N.Y.S 884 (2d Dep't 1985). Further, the Treasury Department and the IRS recognize that, in the absence of a zero basis rule for unreported property, existing Federal tax enforcement mechanisms under subtitle F of the Code, including criminal liability, serve to deter willful nonreporting of property on the estate tax return. *See*, *e.g*., section 6651(a)(3) of the Code for a potential addition to tax; sections 6662(a), (g), and (h), 6663, 6721, and 6722 of the Code for potential accuracy-related, fraud, and other penalties; section 6501(c)(1) and (2), and (e)(2) of the Code for potential exceptions to the general three-year period of limitations on assessment; and sections 7203, 7206, and 7207 of the Code for potential criminal liability and penalties.
>
> In view of these considerations, the final regulations do not include the zero basis rule. Instead, §1.1014-10(c)(1)(i) of the final regulations clarifies that the consistent basis requirement applies only to *included property*, a term that is defined in §1.1014- 10(d)(4) of the final regulations to refer to property, the value of which is included in the value of the decedent's gross estate, as defined in section 2031 or 2103. [See below]

A second controversial rule, and one that might also be challenged in a post-Chevron environment, is the subsequent transfer reporting rule. Again, in the Final Regulations Treasury argues it has authority to issue the rule, and then goes on to narrow it The Proposed Regulations applied to all recipients of estate assets; the Final Regulations apply only to trustees The Summary explains Treasury's reasoning:

> Proposed §1.6035-1(f) would impose a reporting requirement with regard to certain subsequent transfers of property previously reported (or required to be reported) on a Statement. Specifically, it would require the recipient of property to which section 6035 applies to file with the IRS a supplemental Information Return, and to furnish to a transferee of the property a Statement, if the recipient (who becomes the transferor) distributes or transfers all or any portion of that property in a transaction in which the transferee determines its basis, in whole or in part, by reference to the transferor's basis.
>
> Commenters asserted that section 6035 imposes reporting requirements on executors, but not on subsequent transferees and, therefore, the Treasury Department and the IRS lack authority to require reporting under section 6035 by beneficiaries who subsequently transfer property acquired from a decedent. Commenters also noted that this reporting requirement could continue for generations, and thus be impossible for the IRS to monitor and enforce, especially with respect to nonresident non-citizen beneficiaries if the property is no longer in the United States. Commenters also noted that this subsequent reporting requirement creates uncertainty for executors, estate tax return preparers, and beneficiaries as to whether supplemental reporting is required, and that the failure to comply with the reporting requirement is subject to penalties. They contended this requirement is particularly unfair with respect to unsophisticated individual recipients who are likely to be unaware of the reporting requirements and, as a result, are more likely to become subject to noncompliance penalties. Finally, commenters noted that, in many cases, the obligation to report the basis of property transferred is duplicative of other required filings.
>
> The Treasury Department and the IRS carefully have reconsidered the benefits and burdens of the proposed subsequent reporting requirement in light of these comments. The enactment of section 1014(f) created the consistent basis requirement, and the enactment of section 6035 gave the IRS the ability to enforce the provisions of section 1014(f) and the related penalty under section 6662(k) for use of an inconsistent estate basis for income tax purposes. Without this proposed reporting requirement, subsequent ownership changes made through nonrealization events would erode the ability of the IRS to enforce the consistent basis requirement under section 1014(f) and the penalty under section 6662(k) for violations of that requirement.
>
> Nevertheless, the Treasury Department and the IRS conclude that the burden of the proposed subsequent reporting requirement, including the potential penalties for noncompliance, is too heavy a burden to impose on individual beneficiaries who, as a practical matter, may have no way of knowing of the existence of, or of how to comply with, this subsequent reporting requirement. The Treasury Department and the IRS, however, also conclude that trustees of trusts are one class of beneficiaries for whom the subsequent reporting requirement would not be sufficiently burdensome to outweigh the needs of, and benefits to, the IRS and trust beneficiaries. Generally, the trustee of a trust is likely to be aware of applicable tax requirements and to be both able and motivated to comply with these requirements. In addition, in discharging the trustee's fiduciary obligations to the trust beneficiaries, a trustee is likely (even without a supplemental reporting

requirement) to provide certain relevant information (such as basis) to the beneficiary to whom the trustee is distributing a trust asset.

Accordingly, the final regulations retain a reporting requirement for subsequent transfers, but this requirement is narrowed significantly. Under §1.6035-1(h)(1) of the final regulations, reporting requirements are imposed on trustees of beneficiary trusts making a distribution of property that was reported on a Statement furnished to those trustees, or of any other property the basis of which is determined, in whole or in part, by reference to the basis of this property. Such a trust distribution includes, for example, a transfer of trust property pursuant to the exercise or lapse of a person's power of appointment (whether general or limited). That section further provides that trustees of trusts that receive a distribution of such property, whether from a beneficiary trust or from any other trust that has received such property, either directly or indirectly, also are subject to these reporting requirements when making a distribution of that property. This reporting obligation imposed on trustees continues to apply for each subsequent transfer or distribution until the property is distributed to a beneficiary not in trust. However, these reporting requirements do not apply if property is disposed of by the trustee in a transaction that is a recognition event for income tax purposes (whether or not resulting in a gain or loss) that results in the entire property having a basis that no longer is related, in whole or in part, to the property's final value or, if applicable, reported value (within the meaning of §1.1014-10(b)(1) or (2) of the final regulations, respectively).

By imposing a reporting obligation on trustees of beneficiary trusts and certain other recipient trusts, the final regulations ensure that an individual or entity likely to incur an income tax realization event with respect to the trust property has the necessary information to determine the correct initial basis. This facilitates the proper reporting of basis and compliance with the consistent basis requirement if it is applicable.

Whether Treasury is correct that trustees generally are more capable than others of this reporting may be questioned. In a post-Chevron world, the likelihood of challenges has increased. Nonetheless, the limitation of the rule is a desirable change.

Another desirable change was made to the rules regarding the reporting of property distributed to beneficiaries. The Proposed Regulations would have required that a beneficiary receive notice of all estate assets that might be distributed to the beneficiary within 30 days after the due date of the Form 706. The Final Regulations delay the reporting until January 31 of the calendar year following acquisition by the beneficiary and modify what a beneficiary must be told. The Summary describes who is subject to the reporting rule like this:

(b) *Applicability of section 6035 reporting requirements*—(1) *In general*. The reporting requirements under section 6035 of the Code apply only in the case of an estate in which the executor is required to file an estate tax return under section 6018 of the Code (determined without regard to §20.2010-2(a)(1) of this chapter) (*required estate tax return*) and the executor files that return after July 31, 2015. The requirements do not apply in the case of an estate whose required estate tax return is filed on or before July 31, 2015, even if the due date of the return is after July 31, 2015, or if one or more supplements to that return are filed with the IRS after July 31, 2015. Whether an estate tax return is a required estate tax return depends on the relevant factors identified in section 6018 and the corresponding regulations, including the date of death value of property includible in the

> decedent's gross estate, the amount of adjusted taxable gifts, and the applicable filing threshold. An election under section 2032 or 2032A of the Code to determine the value of the gross estate in accordance with those respective provisions is not relevant to whether an executor is required to file an estate tax return under section 6018. If an estate tax return is not required to be filed under section 6018 based on the relevant factors identified in section 6018, then an estate tax return filed for another purpose (such as to make a portability election under section 2010(c)(5) of the Code, an allocation or election under section 2632 of the Code with regard to a decedent's generation-skipping transfer tax exemption, or a protective filing to avoid a penalty or satisfy a State law requirement) is not a required estate tax return for purposes of this section.
>
> (2) *Executor(s) subject to section 6035 reporting requirements*. For purposes of this section, the term *executor* has the same meaning as in section 2203 of the Code, as expanded to include all persons required under section 6018(b) to file an estate tax return. Thus, more than one person may be subject to the reporting requirements for the same decedent's estate. If one executor is unable to file a complete estate tax return (for example, if the executor has insufficient information about property in the decedent's gross estate that is not in the possession of that executor), each person required to file a return is subject to the reporting requirements of this section only with regard to the property reported (or required to be reported) on the estate tax return required to be filed by that person. Similarly, if no executor is appointed by a court, each person in actual or constructive possession of any property of the decedent is an executor for purposes of this section and is subject to the reporting requirements of this section, but only with regard to the property reported or required to be reported on the estate tax return required to be filed by that executor under section 6018(b).

(examples omitted)

If a federal estate tax return is required, then a Form 8971 must be filed with "Required Statements" attached. The Required Statements are described by the Summary as follows:

> For purposes of this section, the term *Statement* refers to the payee statement described as Schedule A of the Information Return to be furnished to a beneficiary, or any successor form, schedule, or procedure designated by the IRS for this purpose. The Statement furnished to a beneficiary must identify that beneficiary's acquired property and its value and other information prescribed by the Statement and the instructions for that form. For each property reported on a Statement, the value the executor reports on that Statement is the value of the property as reported on the estate tax return filed with the IRS. Generally, this is the value of the property on the date of the decedent's death, except in the case of an election in which the value is determined under section 2032 or 2032A, in which case it is the value determined under the applicable provision. If different interests in the same property pass from the decedent to one or more income beneficiaries or life tenants and remaindermen, the value to be reported is the value of the entire property and each recipient will be responsible for identifying his or her respective share of uniform basis. For the duty to supplement the Statement in the event of a change to the information required to be reported, including a change in the identified value of property reported on a Statement, see paragraph (d) of this section.

There are several potential due dates to bear in mind, as well as transition rules:

> (3) *Due dates*—(i) *General rule*. Except as provided in paragraphs (c)(3)(ii) and of this section and in §1.6035-2, the executor must file the Information Return with the IRS on or before the due date specified in this paragraph (c)(3)(i). In addition, each Statement, a copy of which is required to be attached to the Information Return, must be furnished to the named beneficiary on or before this same due date. The Information Return must be filed, and each such Statement (if any) must be furnished to its named beneficiary, on or before the earlier of—
>
> (A) The date that is 30 days after the due date of the estate tax return required under section 6018 (including extensions, if any); or
>
> (B) The date that is 30 days after the date on which that estate tax return is filed with the IRS.
>
> (ii) *Due date and applicable rules if property is acquired subsequently by beneficiary*. If a beneficiary acquires property subject to reporting after the due date of the estate tax return (or the earlier filing of the Information Return), the executor must furnish a Statement to that beneficiary with regard to that acquired property on or before January 31 of the year following the beneficiary's acquisition of that property. By that same January 31, the executor also must attach a copy of the Statement to a supplement to the Information Return (a supplemental Information Return) and must file the supplemental Information Return with the IRS. The supplemental Information Return must include a copy of each Statement required to be furnished for that year pursuant to this paragraph (c)(3)(ii), as well as a copy of each Statement (if any) furnished in accordance with paragraph (c)(5) of this section that has not already been filed with the IRS as an attachment to the Information Return or a supplement to the Information Return. The requirements of this paragraph (c)(3)(ii) do not apply if the property already has been reported on a Statement furnished pursuant to paragraph (c)(5) of this section. See this paragraph (c)(3) and paragraph (d)(4) of this section for the due date of other required supplements to this reporting.
>
> (iii) *Transition rule*. If the due date of an estate tax return required to be filed by section 6018 is on or before July 31, 2015, but the executor does not file the estate tax return with the IRS until after July 31, 2015, then the Information Return and all required Statements are due on or before the date that is 30 days after the date on which the estate tax return is filed, except as provided in §1.6035-2.

The date on which a beneficiary acquires an interest may be key Accordingly, the Final Regulations explain that a beneficiary acquires property "when, under local law, title vests in the beneficiary or when the beneficiary otherwise has sufficient control over or connection with the property that the beneficiary is able to take action related to the property for which basis is relevant for Federal income tax purposes (such as, for example, to sell or depreciate the property). In many cases, a beneficiary's acquisition of property occurs upon an executor's or trustee's distribution of the property. For property passing by contract or by operation of law, the beneficiary's acquisition of that property generally occurs automatically upon the death of the decedent." If state law vests real estate in a beneficiary immediately upon the decedent's death, subject to a power of sale in the executor (and to creditors of the decedent's estate), when does the beneficiary acquire the property? On these facts, the beneficiary may be able to sell the property but not pass good title to the purchaser. The notion of "vesting" in such a context may not be the appropriate date of measurement.

An executor may find it efficient to furnish the required statements before the beneficiary acquires the property. The Final Regulations allow the executor to do so, as described by the Summary:

> (5) *Option to furnish Statement(s) prior to the acquisition of property by a beneficiary*. An executor may satisfy the requirement in paragraph (c)(2) of this section to furnish a Statement to a beneficiary by furnishing the Statement to the beneficiary prior to the beneficiary's acquisition of the property subject to reporting under paragraph (e) of this section, provided that the executor has reason to believe that the beneficiary will acquire that property. The Statement furnished to such a beneficiary must identify the property the beneficiary is expected to acquire as well as the value of that property and other information prescribed by the Statement and the instructions for that form (and must include information relating to other property actually acquired by such beneficiary as may be required under paragraph (c)(2) of this section). If, after satisfying the requirements of this paragraph (c)(5), the property is acquired by a different beneficiary, the executor must update the beneficiary information in the Information Return and furnish a Statement to that beneficiary pursuant to the duty to supplement to report a change in beneficiary information as described in paragraph (d)(2)(i) of this section. The executor additionally is subject to the duty to supplement to report other changes to the information required to be reported as identified in paragraph (d) of this section.
>
> ***
>
> (iv) *Change in property to be acquired by beneficiary*. A duty to supplement will arise if an executor furnishes a Statement to a beneficiary prior to the beneficiary's acquisition of property pursuant to paragraph (c)(5) of this section and the beneficiary ultimately acquires property different from the property identified on that Statement. A beneficiary's acquisition of different property may occur for any reason, including an executor's receipt of different property in a transaction in which the basis of the new property received by the executor is determined, in whole or in part, by reference to the final value of property acquired from or as a result of the death of the decedent (for example, as the result of a like-kind exchange under section 1031 or an involuntary conversion).
>
> (3) *Exceptions*; *no duty to supplement despite certain changes*. Notwithstanding paragraph (d)(2) of this section, no supplemental reporting under this section is required for:
>
> (i) Inconsequential errors or omissions within the meaning of §301.6722-1(b) of this chapter;
>
> (ii) Changes resulting from an event that triggers an additional estate tax under section 2032A, including changes in value in the event of a beneficiary election under section 1016(c) of the Code;
>
> (iii) Adjustments to the basis of property pursuant to sections of the Code other than section 1014(f); and
>
> (iv) Any other change that is identified as requiring no supplemental reporting under this section in published guidance in the **Federal Register** or in the Internal Revenue Bulletin (*see* §601.601(d)(2)(ii)(*b*) of this chapter).

> (4) *Due date of supplemental reporting*. The supplemental reporting required by this paragraph (d) must be filed with the IRS and furnished to each affected beneficiary on or before 30 days after the date on which information becomes available to the executor from which the executor can conclude that a change to the information provided on the Information Return or Statement (or supplement to either) requires supplemental reporting. For changes occurring as a result of supplementing the estate tax return, the date on which the information becomes available to the executor is deemed to be the filing date of the supplemental information. Therefore, for changes occurring as a result of supplementing the estate tax return, the due date of the supplemental reporting required by this paragraph (d) is 30 days after the filing date of the supplemental information. For changes occurring as a result of a determination of final value, the date on which the information becomes available to the executor is deemed to be the date a value becomes the final value under §1.1014-10(b)(1). Therefore, for changes occurring as a result of a determination of final value, the due date of the supplemental reporting required by this paragraph (d) is 30 days after the date a value becomes the final value under §1.1014-10(b)(1). However, with regard to property that has not been acquired by a beneficiary on or before the due date described in this paragraph (d)(4) and for which a Statement was not provided to the beneficiary pursuant to paragraph (c)(5) of this section, the due date may be delayed until the due date described in paragraph (c)(3)(ii) of this section.
>
> (5) *Duration of duty to supplement*. An executor's duty to supplement as described in this section continues to apply until a final determination of value for Federal estate tax purposes (a final value within the meaning of §1.1014-10(b)(1)) is determined for all property subject to reporting (under paragraph (e) of this section) or, if later, until such property has been acquired by a beneficiary. Therefore, the executor's final supplemental reporting is the reporting to the IRS and the furnishing of Statements to beneficiaries with regard to the last to occur of these two events, assuming that either event would create a change requiring supplemental reporting.

Reporting is required for all property included in a decedent's gross estate, and property determined with reference to such property The Summary States:

> (e) *Property for which reporting is required*—(1) *In general*. Except for excepted property subject to only limited reporting as described in paragraph (f) of this section, the property subject to reporting under this section is *included property* and any other property the basis of which is determined, in whole or in part, by reference to the basis of the included property (for example, property acquired in a like-kind exchange or an involuntary conversion). For purposes of this section, *included property* is property the value of which is included in the value of the decedent's gross estate as defined in section 2031 or 2103. Generally, included property refers to property whose value is reported on an estate tax return, but it also refers to property whose value otherwise is included in the total value of the gross estate (for example, during examination by the IRS). Thus, included property includes property that qualified, in whole or in part, for an estate tax marital deduction under section 2056, 2056A, or 2106(a)(3) or for an estate tax charitable deduction under section 2055 or 2106(a)(2). It further includes property included in the decedent's gross estate that is distributed to a surviving spouse in satisfaction of that surviving spouse's interest in community property not included in the gross estate that the executor has distributed to a non-spouse pursuant to State law properly applied. However, included property does not include property whose value is not reported on an estate tax return and whose value is not otherwise included in the value of the decedent's gross estate, such as

> the property of a deceased nonresident noncitizen that is not subject to United States estate tax, and the surviving spouse's share of community property described in section 1014(b)(6).

There are certain exceptions – property for which the basis would be so obvious that reporting would be silly. The executor is not required to identify or provide any other information for excepted property on the Information Return, and the executor is not required to furnish a Statement to the beneficiary with regard to that property. Instead, the executor only reports on the Information Return that some or all of the property subject to reporting is excepted property, and does the same when reporting to a beneficiary. So, what is excepted property? The Summary explains:

> (f) *Excepted property* requiring *only limited reporting*—(1) *Excepted property*. Certain included property that is described in paragraph (f)(2) of this section (excepted property) is subject to more limited reporting than the reporting required under paragraph (c) of this section. The requirement to file an Information Return with the IRS as described in paragraph (c)(1) of this section remains the same even if all property subject to reporting under paragraph (e) of this section is excepted property. However,
>
> (2) *List of excepted property*. Excepted property includes—
>
> (i) United States dollars (as defined in paragraph (f)(3) of this section).
>
> (ii) United States dollar-denominated demand deposits.
>
> (iii) Certificates of deposit denominated in United States dollars.
>
> (iv) Cash collateral denominated in United States dollars held by a third party to secure a liability (such as a deposit of purchase money or a security deposit).
>
> (v) Shares of a registered investment company priced in United States dollars that is a money market fund under Rule 2a-7 under the Investment Company Act of 1940 (17 CFR 270.2a).
>
> (vi) Life insurance proceeds on the life of the decedent payable in a lump sum in United States dollars.
>
> (vii) Federal, State, and local tax refunds and other refunds payable in United States dollars.
>
> (viii) Notes that are forgiven in full by the decedent upon the decedent's death, whether or not denominated in United States dollars.
>
> (ix) Household and personal effects for which an appraisal is not required under §20.2031-6(b) of this chapter.
>
> (x) Property that, prior to distribution from the estate or the decedent's revocable trust, is completely sold, exchanged, or otherwise disposed of in one or more transactions that are recognition events for Federal income tax purposes (whether or not resulting in a gain or loss, and whether or not any gain is capital or ordinary). Such property includes, but is not limited to -
>
> (A) Property distributed in satisfaction of a pecuniary bequest on which the estate recognizes any gain or loss pursuant to §1.661(a)-2(f);

(B) Property for which an election under section 643(e)(3) has been made for the estate to recognize any gain or loss;

(C) Interests in a business entity that are redeemed for United States dollars prior to being distributed to the beneficiary;

(D) Property disposed of in a transaction described in section 267(a) and (b)(13); and

(E) Property subject to the mark to market accounting method at the time of distribution from the estate or from the decedent's revocable trust.

(xi) Other property having an initial basis that is not in any way determined with regard to or derived from the property's fair market value for Federal estate tax purposes. For purposes of this section, such property includes but is not limited to—

(A) Annuity contracts subject to section 72 and amounts received as an annuity subject to section 72;

(B) An interest in property that consists entirely of the right to receive an item of income in respect of a decedent as defined in section 691;

(C) Amounts received under installment obligations arising from a transaction for which the installment method for determining gain under section 453 applies;

(D) Appreciated property described in section 1014(e) that is acquired by the decedent within 1 year of death;

(E) Stock of a passive foreign investment company subject to section 1296(i), but only if the basis of such stock is the adjusted basis in the hands of the decedent immediately before the decedent's death; and

(F) Interests in and distributions from retirement plans and deferred compensation plans, including individual retirement arrangements as defined in sections 408 and 408A, that are expressed entirely in United States dollars.

(xii) Bonds to the extent that they are redeemed by the issuer for United States dollars prior to being distributed to a beneficiary so that any resulting gain or loss is recognized by the estate.

(xiii) Property included in the gross estate of a beneficiary who died before the due date of the Information Return.

(xiv) Any other property that is identified as excepted property in published guidance in the **Federal Register** or in the Internal Revenue Bulletin (*see* §601.601(d)(2)(ii)(*b*) of this chapter).

(3) *United States dollars defined*. For purposes of this paragraph (f), the term *United States dollars* means the official currency of the United States. The term United States dollars includes physical bills and coins for which the value of each bill or coin is equivalent to the face amount of that bill or coin. This definition does not include other physical United States bills or coins with numismatic value because these bills or coins typically do not have a value equal to their face value.

In case we don't know who a beneficiary is, the Final Regulations tell us:

> (g) *Beneficiaries*—(1) *In general*. Each person who acquires (or will acquire) property from a decedent or by reason of the decedent's death that is subject to the reporting described in paragraph (e) of this section is a beneficiary for purposes of this section and thus is a person to be listed on the Information Return and, except with respect to excepted property (described in paragraph (f) of this section), is a person to whom the executor must furnish a required Statement. Thus, a beneficiary may be:
>
> (i) An individual, including one who is both the executor and a beneficiary, who acquires (or will acquire) property subject to reporting not in trust;
>
> (ii) The estate of a deceased individual who survived the decedent if such individual or estate acquires (or will acquire) property subject to reporting not in trust;
>
> (iii) A trust, whether foreign or domestic, including without limitation a grantor retained annuity trust, charitable remainder trust, and charitable lead trust (each referred to in this section as *beneficiary trusts*); or
>
> (iv) An entity other than a trust, including without limitation a business entity or an organization described in section 501(c).
>
> (2) *Required Statement to beneficiary trust*—(i) *In general*. If a beneficiary trust is the beneficiary to be identified on the Information Return pursuant to paragraph (g)(1) of this section, the executor must furnish the Statement described in paragraph (c)(2) of this section to the trustee rather than to the beneficiaries of the trust. However, if the executor reasonably believes that it is unlikely that the beneficiary trust will depreciate, sell, or otherwise dispose of the property subject to reporting in a recognition event for income tax purposes but instead will distribute the property in kind to the trust beneficiaries, the executor instead may furnish the Statement described in paragraph (c)(2) of this section to each of the trust beneficiaries, with copies of the Statements to the trustee. For this purpose, the trust beneficiaries include all potential current income beneficiaries and each remainderman who would have had a current interest in the trust if one or more of the income beneficiaries had died immediately after the decedent. For purposes of determining the due date of such Statements, each trust beneficiary will be deemed to have acquired the trust property when the trust acquired that property.
>
> (ii) *Beneficiary trust not yet established*. If, by the date required for filing the Information Return with the IRS, a beneficiary trust does not have at least one trustee and a tax identification number, an executor must report on the Information Return that the beneficiary trust has not yet been established in accordance with the instructions. Once the beneficiary trust has been established and the trust information becomes available to the executor, the executor must supplement the required reporting as described in paragraph (d) of this section to update the beneficiary information on the Information Return and Statement.
>
> (3) *Required Statement to the holder of a split interest in property*, *not in trust*. The beneficiary of a life estate not in trust, and thus the beneficiary to whom the executor is to furnish any required Statement, is the life tenant. Similarly, the beneficiary of a remainder interest not in trust is each remainderman identified as if the life tenant were to die immediately after the decedent. For purposes of determining the due date of the Statements reporting these interests under

paragraph (c)(3) of this section, each beneficiary will be deemed to have acquired the property subject to reporting on the date of the decedent's death. The beneficiary of a contingent interest, not in trust, is a beneficiary only if the contingency occurs before the end of the period during which the executor has an obligation to supplement the reporting as provided in paragraph (d)(5) of this section. If the contingency occurs during this period, the executor must update the beneficiary information on the Information Return and furnish a Statement to that beneficiary pursuant to the executor's duty to supplement to report a change in beneficiary information as described in paragraph (d) of this section. Usufruct interests are treated in the same manner.

(4) *Reporting for a missing beneficiary*. If the executor is unable to locate a beneficiary by the date required for filing the Information Return with the IRS, the executor must report on the Information Return the failure to locate the beneficiary and the efforts the executor has made to locate the beneficiary. The executor must supplement the Information Return and must furnish the required Statement, as provided in paragraph (d) of this section, to report the subsequent location of the beneficiary or, if the beneficiary is not located, to report the distribution of the property subject to reporting to a different beneficiary.

(h) *Reporting requirements applicable to trustees*—(1) *Circumstances under which trustees of beneficiary trusts and other trusts are subject to reporting*. Trustees of beneficiary trusts making a distribution of property that was reported on a Statement furnished to those trustees, or of any other property the basis of which is determined, in whole or in part, by reference to the basis of property subject to reporting under paragraph (e) of this section, are subject to the reporting requirements described in paragraph (h)(2) of this section and the supplemental reporting requirements described in paragraph (d) of this section (to the extent applicable) with respect to such property. In addition, trustees of trusts that receive a distribution of such property, whether from a beneficiary trust or from any other trust that has received such property, either directly or indirectly, also are subject to these reporting requirements when making a distribution of that property. This reporting obligation imposed on trustees continues to apply for each subsequent transfer or distribution until the property is distributed to a beneficiary not in trust. However, no trustee of a beneficiary trust or of a subsequent recipient trust is subject to the reporting requirements described in paragraph (h)(2) of this section for a disposition of property in a transaction that is a recognition event for income tax purposes (whether or not resulting in a gain or loss) that results in the entire property having a basis that no longer is related, in whole or in part, to the property's final value or, if applicable, reported value (within the meaning of §1.1014-10(b)(1) or (2), respectively).

(2) *Required reporting*. On or before January 31 of the calendar year immediately following the year during which occurs a distribution of property subject to reporting under this paragraph (h), the trustee making the distribution must file an Information Return in accordance with the instructions for that form and must furnish a Statement to each recipient of the distribution. For purposes of this section, each recipient is a beneficiary.

***

Finally, to reduce burden and improve administrability, §1.6035-1(h)(2) of the final regulations adopts the same due date for the filing of the Information Return and the furnishing of the Statement with regard to distributions of property by trustees as is required under §1.6035-1(c)(3)(ii) of the final regulations, which is January 31 of the year following the distribution. Section 1.6035-1(h)(3) of the

> final regulations adds an example illustrating the application of the reporting requirements applicable to trustees making subsequent transfers of property if the property is subject to reporting under §1.6035-1(e) of the final regulations.

In certain instances, the future reporting issues may be expected to be onerous. Suppose a substantial amount of a decedent's assets are owned by the decedent's revocable trust. If the trust provided that the assets of the revocable trust were divided in half shortly after the date of death, and then the assets were swapped between the trusts when some minimal amount of appreciation had occurred that would be a recognition event which would forestall future reporting with respect to those assets. Quite obviously, the separate trusts would need to be different income tax payers. The same approach could be used in other contexts.

2. **<u>No Basis Adjustment For Grantor Trust Property</u>**. Basis is an income tax concept.

> Section 1012(a) provides that the basis of property is its cost, except as otherwise provided in subchapter O of chapter 1 (subchapter O) (relating to gain or loss on disposition of property) and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses) of chapter 1. One of the provisions set forth in subchapter O is § 1014.

Rev. Rul. 2023-2 deals with the application of section 1014 to a grantor trust if the trust assets are not included in the grantor's estate at death. The Ruling deals with simple, yet everyday, facts:

> In Year 1, A, an individual, established irrevocable trust, T, and funded T with Asset in a transfer that was a completed gift for gift tax purposes. A retained a power over T
>
> that causes A to be treated as the owner of T for income tax purposes under subpart E of part I of subchapter J of chapter 1 (subpart E). A did not hold a power over T that would result in the inclusion of T's assets in A's gross estate under the provisions of chapter 11. By the time of A's death in Year 7, the fair market value (FMV) of Asset had appreciated. At A's death, the liabilities of T did not exceed the basis of the assets in T, and neither T nor A held a note on which the other was the obligor.

The Ruling's analysis is equally straightforward:

> For property to receive a basis adjustment under § 1014(a), the property must be acquired or passed from a decedent. For property to be acquired or passed from a decedent for purposes of § 1014(a), it must fall within one of the seven types of property listed in § 1014(b). Asset does not fall within any of the seven types of property listed in § 1014(b).
>
> First, upon A's death, Asset was not "bequeathed," "devised," or "inherited" within the meaning of § 1014(b)(1). A "bequest" is the act of giving property (usually personal property or money) by will. Black's Law Dictionary (11th ed. 2019). The Supreme Court defined "bequest" as a "gift of personal property by will" for purposes of the predecessor provision of § 102 that, as today, excluded gifts, bequests, devises, or inheritance from gross income for income tax purposes. <u>United States v. Merriam</u>, 263 U.S. 179, 184 (1923).

> A "devise" is the act of giving property, especially real property, by will. Black's Law Dictionary (11th ed. 2019). Volume 97 of the *Corpus Juris Secundum* notes that although "bequest" and "bequeath" strictly refer to a gift by will of personal property, the words may be given a broader meaning to include real property which, under the narrower definition, would be a devise. See 97 C.J.S. Wills § 1861 (2022).
>
> An "inheritance" is property received from an ancestor under the laws of intestacy or property that a person receives by bequest or devise. Black's Law Dictionary (11th ed. 2019).
>
> In Bacciocco v. United States, 286 F.2d 551, 554-55 (6th Cir. 1961), the court found that property transferred in trust prior to the decedent's death is not bequeathed or inherited because it did not pass either by will or intestacy. The court stated, "[w]e construe those terms [bequest and inheritance] according to their usual and normal meaning" and noted that the decedent's death did not transfer the assets to the trust. Id. at 554-56. This does not imply that property in a trust could never fall within the meaning of § 1014 (such as property included in the decedent's gross estate or property specifically described by §§ 1014(b)(2), (3), or (4)); however, in the facts outlined above, the trust property does not fall within the meaning of those terms.
>
> The Congressional committee report explaining the basis of property acquired from a decedent for purposes of § 1014(b) (then designated § 113(a)(5) of the 1939 Code) stated that the provision "applies basically to property in the decedent's probate estate and includible in his gross estate under § 811(a) [the predecessor provision of § 2031(a)]. In addition, it applies to property acquired by certain specifically described methods of disposition which are treated as though the acquisition was by bequest, devise, or inheritance." H.R. Rep. No 83-1337 at 4407-08 (March 9, 1954). Citing that report, the court in Collins v. United States, 318 F. Supp. 382, 386 (C.D. Cal. 1970) stated, "[i]t seems clear that property cannot be said to come from a decedent by 'bequest, devise, or inheritance' unless it is part of the decedent's probate estate under the laws of the state of his domicile." [3] The court determined that payments made to a widow by her deceased husband's employers, under contracts negotiated by her husband, did not pass from the decedent under § 1014 and so would not acquire a basis determined by the contract's FMV at the decedent's death but instead were income with respect to a decedent that would not receive a basis adjusted to date of death value.
>
> Second, Asset does not fall within any of the remaining types of property listed in § 1014(b). Asset is not described in §§ 1014(b)(2), (3), or (4) because A did not retain a power to revoke or amend T or hold a power to appoint Asset. Asset also is not described by § 1014(b)(6) because it is not community property. Finally, Asset is not described by §§ 1014(b)(9) or (10) because it is not included in A's gross estate under the provisions of chapter 11. Because at A's death Asset does not fall within any of the seven types of property listed in § 1014(b), Asset does not receive a basis adjustment under § 1014(a) at A's death.

The vast preponderance of practitioners familiar with this issue already held the view expressed in the Ruling. On a related point, the Ruling has caused some reconsideration of the question of income realization when a decedent holds a note from a grantor trust and dies. The best answer for why there is no gain recognition is that there is no abuse that ought be corrected: the trust receives carryover basis and cannot use the appreciated assets it now owns to satisfy the note without gain.

B. CHARITABLE AND TAX-EXEMPT MATTERS - Sections 170, 642, 664, 501, 509, 2055, 2522, and 4940-4947

1. Charitable Distributions From Trusts. Suppose a trust does not provide for distribution to charity but the beneficiaries desire such distributions to occur. If the trust is modified validly under state law to allow charitable distributions, will that allow the trust to take a section 642(c) deduction? In CCA 201651013 the IRS concluded no because the trust after modification was not the "governing instrument."

The IRS also held that a 661, DNI, deduction would not be available. This result is controversial as the ruling notes. Commentators are divided, for instance:

> One standard treatise supports them on two policy grounds: "All of the courts but one [U.S. Trust District Court] that have considered this issue have sustained these regulations, even though they substantially exceed the scope of the statutory language . . . The cases supporting the regulations take the appropriate view because a contrary rule has the effect of giving both an estate tax deduction (for the charitable disposition) and an income tax deduction (for the item distributed to charity) for the same payment. "Also, as a result of deducting distributions of corpus to charity, the non-charitable legatees in effect receive the estate's income tax-free. The benefit of the income tax deduction inures to the noncharitable legatees, rather than to the charity, so the court decisions favoring the regulation seem fundamentally sound." [citations omitted] Danforth, Robert T., et al., Federal Income Taxation of Estates and Trusts [current through 2016], at 4.07[1]
>
> However, at least as many secondary sources in this area disagree with the disallowance under § 661(a), at least under some facts. Another standard treatise, Ferguson, M. Carr, et al, Federal Income Taxation of Estates, Trusts, & Beneficiaries (current through 2016), states at § 6.10: "The analysis [explaining why a single payment should not allow double deduction under §§ 642(c) and § 661(a)] does not, however, answer the question whether amounts that pass to charity in such a way as not to qualify for the deduction under § 642(c), such as amounts that pass to nonqualified quasi-charitable organizations or are used for purposes that are not exclusively charitable, escape the proscription of § 663(a)(2). Obviously, such amounts do *not* qualify 'for the deduction provided in § 642(c).' Are they therefore deductible as distributions under § 661? A literal reading of the statute strongly suggests that many such amounts should be. Even an undisputedly charitable beneficiary would be treated the same as any other beneficiary under the distribution rules, if it were not for §§ 642(c) and 663(a)(2). When no deduction is available under § 642(c), § 663(a)(2) seems to plainly not apply."

The taxpayer attempted to inspire the IRS to accept a bona fide state court modification to the trust instrument as being the "governing instrument" but the IRS rejected inspiration in CCA 201747005. The taxpayer and the IRS settled the case but the IRS did not concede the point.

There is no evidence that this is part of a larger exercise to limit the tax effect of prospective state court modifications (for instance, adding general power for basis). If a trust cannot be effectively amended, what can be done to obtain a charitable deduction for trust income? The assets of the trust could be contributed to an S corp. and the trust could become an ESBT. Or, distributions could be made to a 501(c)(4) organization, for which a section 661 deduction is allowable. A third way is that Rev. Ruling 2004-05 may help.

Gifts by partnerships or LLCs are deductible proportionately by the partners or members. IRC § 702(a)(4). Rev. Rul. 96-11 holds that when a partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership should be decreased, but not below zero, by the partner's share of the partnership's basis in the property contributed. Similarly, a partner's charitable deduction for the contribution of appreciated property by the partnership does not seem to be limited to her share of the partnership's basis in the assets. See Private Letter Ruling 8405084. Thus, contributions of appreciated property by partnerships preserve the tax benefit of receiving a deduction at fair market value for the contribution of appreciated property; the unrealized appreciation is not transferred to the partner's interest in the partnership.

Note that under the OBBBA the 0.5% AGI limitation applies to trusts and "solutions" to the section 642(c) problem will not avoid it. This also produces a tax-on-tax calculation if all of the trust's income is paid to the charity as in, for instance, a charitable lead annuity trust.

Rev. Rul. 2004-05 provides that a trust which is a partner will benefit from a charitable contribution made by the partnership even if the trust itself has no charitable beneficiaries. The Ruling does not state how the trust came to be a partner. May a trust with no charitable beneficiaries become a partner in a partnership which allows charitable contributions without the consent of the trust partner? Presumably the answer is yes so long as the beneficiaries are agreeable. See also Private Letter Ruling 200208019, in which the IRS considered whether the members of a partnership were entitled to a charitable deduction on account of the partnership's grant of a conservation easement to a charitable organization. The IRS concluded that each partner was entitled to a charitable deduction equal to each partner's distributive share of the gift. A trust could <u>not</u> benefit from that deduction because §642(c) allows only deductions for income.

PLR 201225004 involved a trust claiming the section 642(c) deduction for income distributed to charity and the requirement that the income be distributed "pursuant to the terms of the governing instrument." Here, the distribution was directed by a beneficiary's exercise of a lifetime special power of appointment and the IRS determined that satisfied the "pursuant to" requirement even though the governing instrument did not specify a charitable bequest. It only authorized exercise of the power in favor of charity. In PLR 9821029, an individual exercised a lifetime nongeneral power of appointment over a trust to create a charitable remainder trust for a term of years with the trust as the unitrust beneficiary. The IRS allowed the trust to be the beneficiary and allowed the charitable remainder trust to be created by the exercise of the power.

A trust could create and own a single-member LLC that gives a charity a right to withdraw "income" as defined under section 678(a)(i). The trustee would fund the LLC with sufficient assets to produce the desired income.

Where assets are paid to a trust then to charity – an IRA for instance – consideration should be given to skipping a step. Payment directly to charity will avoid 2/37ths cut-back.

If a charity is given the right to withdraw a portion of the income and gains from a trust then the charity is the owner of that portion under section 678 which avoids the need for a section 642(c) deduction, and avoids the 0.5% AGI limitation. This is a "BDOT solution".

In PLR 202423002 the IRS allowed a trust a 642(c) set aside deduction because a revocable trust had agreed to a section 645 election to be taxed as part of an estate. The IRS noted this result is specifically allowed by the 645 regulations:

> Section 1.645-1(e)(2)(iv) provides that a deduction is allowed in computing the taxable income of the combined electing trust and related estate to the extent permitted under §642(c) for — (A) Any amount of the gross income of the related estate that is paid or set aside during the taxable year pursuant to the terms of the governing instrument of the related estate for a purpose specified in §170(c); and (B) Any amount of gross income of the electing trust that is paid or set aside during the taxable year pursuant to the terms of the governing instrument of the electing trust for a purpose specified in §170(c).
>
> Section 1.645-1(f)(1) states that the election period begins on the date of the decedent's death and terminates on the earlier of the day on which both the electing trust and related estate, if any, have distributed all of their assets, or the day before the applicable date. The election does not apply to successor trusts (trusts that are distributees under the trust instrument).
>
> Section 1.645-1(f)(2) provides that the applicable date means — (i) If a Form 706 is not required to be filed as a result of the decedent's death, the applicable date is the day which is 2 years after the date of the decedent's death, (ii) If a Form 706 is required to be filed as a result of the decedent's death, the applicable date is the later of the day that is 2 years after the date of the decedent's death, or the day that is 6 months after the date of final determination of liability for estate tax. Solely for purposes of determining the applicable date under §645, the date of final determination of liability is the earliest of the following — (A) The date that is six months after the issuance by the Internal Revenue Service of an estate tax closing letter, unless a claim for refund with respect to the estate tax is filed within twelve months after the issuance of the letter; (B) The date of a final disposition of a claim for refund, as defined in §1.645-1(f)(2)(iii), that resolves the liability for the estate tax, unless suit is instituted within six months after a final disposition of the claim; (C) The date of execution of a settlement agreement with the Internal Revenue Service that determines the liability for the estate tax; (D) The date of issuance of a decision, judgment, decree, or other order by a court of competent jurisdiction resolving the liability for the estate tax unless a notice of appeal or a petition for certiorari is filed within 90 days after the issuance of a decision, judgment, decree, or other order of a court; or (E) The date of expiration of the period of limitations for assessment of the estate tax provided in §6501.

The overall plan in the PLR was interesting:

The information submitted states that Trust was established by Decedent before his death under the laws of State as a revocable trust. During Decedent's life, Trust was treated as a grantor trust under §676 for federal tax purposes. The trust agreement provides that after payment of certain specific bequests and all taxes, administrative costs and debts, the residue of Trust is to be distributed to Foundation.

Foundation is a charitable private foundation, exempt from tax under §501(c)(3), formed under the laws of State. Foundation is the sole remaining beneficiary of Trust. Trust represents that the likelihood that its assets will not be distributed to Foundation is negligible because pursuant to the trust agreement and the laws of State, all creditors of Trust are paid or considered paid.

Estate is the estate of Decedent. Pursuant to Decedent's Will, the residue of Estate is to be distributed to the trustees of Trust. Estate and Trust represent that they timely filed a valid election under §645 to treat Trust as part of Estate for federal tax purposes. Trust represents that because it was a qualified revocable trust within the meaning of §645 during Decedent's life, it was eligible to make the election under §645.

Trust is the sole shareholder of the Corporation, a corporation formed under the laws of State, treated as an S corporation for federal tax purposes. The Corporation owns Real Property, which is located in State. The Real Property consists of parcels of unimproved land, except for one parcel which includes an office building that is leased to an unrelated person. Before Decedent's death, Corporation was considered a dealer of real property, treating gain or loss from the sale of any real property as ordinary income or loss.

The Corporation, a cash method taxpayer, intends to make a non-liquidating distribution of all the Real Property consisting of unimproved land, but not the office building, to its sole shareholder, Trust. Trust acknowledges that the distribution will result in the Corporation recognizing gain under §311(b) equal to the excess of the Real Property's fair market value over the Corporation's adjusted basis in the Real Property in the taxable year of the distribution. Trust further acknowledges that Trust, a cash method taxpayer, will be required to take that gain into gross income under §1366(a) in the taxable year of the distribution.

Trust represents that it intends to sell the Real Property to an unrelated purchaser. During the period before the sale, when Trust holds the Real Property, or after the sale, when Trust holds the sale proceeds, Trust represents that the Real Property or sale proceeds will be accounted for separately and permanently set aside for the benefit of Foundation.

If Trust is able to sell the Real Property in the same taxable year that the Corporation distributes the Real Property to Trust, Trust represents that it intends to distribute the net sale proceeds to Foundation in the same taxable year in which it receives the sale proceeds or the taxable year immediately following such taxable year pursuant to a valid election under §645(c)(1).

Trust requests a ruling that it will be allowed a charitable contribution deduction under §642(c) to the extent that the Corporation actually distributes the Real Property to Trust and Trust either pays or permanently sets aside the Real Property or the net proceeds from the sale of the Real Property for the benefit of Foundation.

2. Use of Section 501(c)(4) Organizations to Facilitate Business Interest Ownership. Under the Protecting Americans from Tax Hikes Act of 2015, Section 2501(a) was amended to specifically exclude from federal gift tax "transfers of money or other property to an organization described in paragraph (4), (5), or (6) of section 501(c) and exempt from tax under section 501(a), for the use of such organization." This exclusion from federal gift tax is applicable to lifetime gifts to section 501(c)(4), (5), and (6) organizations, but does not apply to transfers at death. Accordingly testamentary transfers to section 501(c)(4), (5), and (6) organizations still would be taxable for estate tax purposes. Moreover, lifetime transfers to these organizations also could be subject to IRC § 2036. No private inurement is permitted for a section 501(c)(4) organization. Effective July 19, 2019, are final regulations under section 506 dealing with the requirement that an organization notify the IRS within 60 days of its intent to operate under section 501(c)(4). TD 9873.

Section 501(c)(4) Organizations include "civic leagues" and "social welfare organizations," which must be nonprofit and organized for the promotion of the common good and general welfare of the community as a whole, and "local associations of employees," in which membership is limited to employees of a particular person or particular person in a designated locality, and the earnings of which must be used for charitable, educational or recreational activities. Specific examples of section 501(c)(4) organizations would be homeowners associations, veterans groups, community centers and community programs, volunteer fire departments, parks associations, public recreational facilities, and service organizations.

A section 501(c)(4) organization does not appear to fit within the definition of "disqualified person," because it is:

- Not a substantial contributor or foundation manager;
- Not an individual
- Not a "35 percent" corporation, partnership, trust or estate; and
- Not a private foundation.

No cases or rulings appear to establish that a section 501(c)(4) organization would be a disqualified person. This may create a useful opportunity to use section 501(c)(4) organizations to avoid excess business holdings and self-dealing issues that could arise from transfers of closely-held business interests to a private foundation.

Section 4943 would preclude a private foundation from long-term ownership of more than 20 percent of the voting stock of a corporation or other business enterprise in combination with all disqualified persons. However, if a section 501(c)(4) organization is not a disqualified person, it could own a "business enterprise" with one or more private foundations in a manner that would avoid violating the prohibition against excess business holdings under section 4943. If an owner transferred interests in a closely-owned business to a private foundation in conjunction with a transfer to a section 501(c)(4) organization, it may be possible to avoid excess business holdings.

To illustrate,

- Donor could recapitalize her closely-held business enterprise from 1 million shares of common stock to 100,000 shares of voting stock and 900,000 shares of nonvoting stock.

- Donor then could contribute 80,000 shares of voting stock to a new section 501(c)(4) organization that Donor's family controls, without incurring gift tax.

- At death, Donor could contribute 20 percent of voting stock and all nonvoting stock to a private foundation, and the section 501(c)(4) organization would own 80 percent of the voting stock.

If a section 501(c)(4) organization is not a disqualified person (even if it is controlled by one or more disqualified persons) it would be permissible for a private foundation and the section 501(c)(4) organization to enter into transactions that ordinarily would be treated as self-dealing. For example a section 501(c)(4) organization could:

- Purchase or borrow assets from a related private foundation.

- Lease real estate to a related private foundation.

- Co-own and co-invest with a related private foundation.

3. Estate Income Tax Deduction. Where a decedent lacks a taxable estate, but wants to make a charitable bequest, consideration should be given to providing that the first dollars of income of the estate go to charity in an amount equal to the amount of the bequest. The estate will receive an income tax deduction if the estate has sufficient income.

4. Pre-Arranged Sales. When a charity sells an asset shortly after contribution, an issue is when will the donor be taxed as if the donor did the selling. Under the anticipatory assignment of income doctrine, a taxpayer who earns or otherwise creates a right to receive income will be taxed on any gain realized from that right if, based on the realities and substance of events, the receipt of income is practically certain to occur, even if the taxpayer transfers the right before receiving the income (see Lucas v. Earl, 281 U.S. 111 (1930)). The related step transaction doctrine similarly prevents a taxpayer from escaping taxation by collapsing a series of substantially linked steps into a single overall transaction (see Penrod v. Commissioner, 88 T.C. 1415, 1428 (1987)).

In Palmer v. Commissioner (62 T.C. 684 (1974), aff'd on other grounds, 523 F.2d 1308 (8th Cir. 1975), acq, 1978-1 C.B. 2), the Tax Court held that a taxpayer's gift of stock in a closely-held corporation to a private foundation, followed by a redemption, would not be characterized as a sale or redemption between the taxpayer and the corporation followed by a gift of the redemption proceeds to the foundation, because the foundation was not legally obligated to redeem the stock at the time it received the shares. In Revenue Ruling 78-197 (1978-1 C.B. 83), the Service announced that it would treat the proceeds of a stock redemption under facts similar to those in the Palmer case as income to the donor only if the donee is legally bound or can be compelled by the corporation to surrender the shares for redemption. The "bright line" test of Palmer and Revenue Ruling 78-197 is not haze free. Many subsequent cases have dealt with this issue including Blake v. Commissioner, 42 T.C.M. 1336 (1981), aff'd, 697 F.2d 473 (2d. Cir. 1982); Ferguson

v. Commissioner, 108 T.C. 244, (1997), aff'd, 174 F.3d 997 (9th Cir. 1999);and Rauenhorst, et al. v. Commissioner, 119 T.C. No. 9 (2002). In Rauenhorst, Arbeit (a partnership) owned warrants enabling it to purchase NMG stock. On September 28, 1993, WCP (a corporation) offered to purchase all NMG stock. On November 9, 1993 the partnership assigned some warrants to four charities. On November 19 Arbeit sold its remaining warrant to WCP, and the charities sold their warrants to WCP. On November 22, 1993, WCP and NMG agreed on a sale of all the NMG stock. The government argued that the bright-line test of Revenue Ruling 78-197 was not controlling. The court held that, based on the facts of the case and the "no legal obligation" test of Palmer and Revenue Ruling 78-197, there was no prearranged sale, and in the process took a very dim view of the government's urging to ignore the ruling:

> While this Court may not be bound by the Commissioner's revenue rulings, and in the appropriate case we could disregard a ruling or rulings as inconsistent with our interpretation of the law, see Stark v. Commissioner, 86 T.C. 243, 251 (1986), in this case it is respondent who argues against the principles stated in his ruling and in favor of our previous pronouncements on this issue. The Commissioner's revenue ruling has been in existence for nearly 25 years, and it has not been revoked or modified. No doubt taxpayers have referred to that ruling in planning their charitable contributions, and, indeed, petitioners submit that they relied upon that ruling in planning the charitable contributions at issue. Under the circumstances of this case, we treat the Commissioner's position in Rev. Rul. 78-197, 1978-1 C.B. 83, as a concession. Accordingly, our decision is limited to the question whether the charitable donees were legally obligated or could be compelled to sell the stock warrants at the time of the assignments.

A footnote to the opinion states as follows:

> The record indicates that no agreement was entered into by the donees before Nov. 19, 1993, the date they signed the warrant purchase and sale agreement. On Nov. 16, 1993, NMG's legal counsel sent letters to each of the donees enclosing a warrant purchase and sale agreement. Those letters state that pursuant to the warrant purchase and sale agreement, the donees would agree to sell their reissued warrants to WCP and "to abstain from either exercising its Warrant or selling or otherwise transferring it to any other party through Dec. 31, 1993." Certainly, the formality of having the donees enter into the warrant purchase and sale agreements suggests that they had not entered into any binding agreements before Nov. 19, 1993.

However, more recently the Tax Court has turned. In Dickinson v. Commissioner, T.C. Memo. 2020-128, Judge Greaves reached the right result but the litigation itself is disturbing. The CFO of a private company donated shares to a donor advised fund (DAF) when allowed to transfer shares by the board, on three occasions. The board was comfortable allowing the transfers because the DAF had a policy of trying to sell closely-held shares quickly which meant, as a practical matter, offering the shares back to the company. In fact, after each donation the company redeemed the shares.

The IRS treated the donation and redemption as an integrated whole to claim the taxpayers in effect sold the stock and contributed the proceeds. Why is puzzling. One would have thought that Rev. Rul. 78-197 would have been dispositive for the taxpayers but apparently not. The opinion discusses that ruling as follows:

> The parties point us to Rev. Rul. 78-197, 1978-1 C.B. 83, a "bright-line" rule the IRS applies in cases like Palmer, which focuses on the donee's control over the disposition of the appreciated property. See Rauenhorst v. Commissioner, 119 T.C. at 165. This Court has not adopted Rev. Rul. 78-197, supra, as the test for resolving anticipatory assignment of income issues, see Rauenhorst v. Commissioner, 119 T.C. at 166, and does not do so today. The ultimate question, as noted in Palmer, is whether the redemption and the shareholder's corresponding right to income had already crystallized at the time of the gift. See Palmer v. Commissioner, 62 T.C. at 694-695. Regardless of whether the donee's obligation to redeem the stock may suggest the donor had a fixed right to redemption income at the time of donation, See Rauenhorst v. Commissioner, 119 T.C. at 166-167, respondent does not allege that petitioner husband had any such right in this case. Accordingly, respondent's resort to Rev. Rul. 78-197, supra, is unavailing.

The opinion relies on a two-prong approach set forth in Humacid Co. v. Commissioner, 42 T.C. 894 (1964), which respected the form of the transaction if the taxpayer (1) gives the property away absolutely and parts with title thereto (2) before the property gives rise to income by way of a sale.

The court determined both prongs were easily met. Even a "preexisting understanding among the parties that the donee would redeem donated stock does not convert a post-donation redemption into a pre-donation redemption."

The opinion notes:

> Furthermore, neither a pattern of stock donations followed by donee redemptions, a stock donation closely followed by a donee redemption, nor selection of a donee on the basis of the donee's internal policy of redeeming donated stock suggests that the donor failed to transfer all his rights in the donated stock. See, e.g., Grove v. Commissioner, 490 F.2d at 242–245 (respecting form of transaction where donee needed to fundraise to support its operations, and over a decade consistently redeemed annual donations of stock for which donor remained entitled to dividends); Carrington v. Commissioner, 476 F.2d at 705–706 (respecting form of transaction where donee redeemed stock eight days after it was donated); Palmer v. Commissioner, 62 T.C. 684, 692–693 (1974), (respecting form of transaction where, pursuant to a single plan, the taxpayer donated stock to a foundation and then caused the corporation to redeem the stock from the foundation the day after the donation), aff'd, 523 F.2d 1308 (8th Cir. 1975). Petitioners' contemporaneous documentary evidence of an absolute gift, and respondent's failure to assert facts indicating any genuine controversy on this point, lead us to conclude that petitioner husband's donations satisfy the first Humacid requirement.

With respect to second prong, the court follows a "practically certain" analysis which is squishier that the bright-line test of Rev. Rul. 78-197:

> Where a donee redeems shares shortly after a donation, the assignment of income doctrine applies only if the redemption was practically certain to occur at the time of the gift, and would have occurred whether the shareholder made the gift or not. See Palmer v. Commissioner, 62 T.C. at 694–695; see also Ferguson v. Commissioner, 174 F.3d 997, 1003–1004 (9th Cir. 1999) (finding that the shareholder recognizes income from a stock sale where acquisition is "practically certain to occur", rather than the subject of "a mere anticipation or expectation",

> before the shareholder donates stock), aff'g 108 T.C. 244 (1997). In Hudspeth v. United States, 471 F.2d 275, 276 (8th Cir. 1972), for example, the court recast a stock donation as a taxable stock sale and donation of the sale proceeds where the taxpayer donated stock after the issuing corporation's directors and shareholders had adopted a plan of complete liquidation. See also Jones v. United States, 531 F.2d 1343, 1343–1344 (6th Cir. 1976); Allen v. Commissioner, 66 T.C. 340, 347 (1976).2 By contrast, there was no assignment of income in Palmer v. Commissioner, 62 T.C. at 687–688, 695, even though all parties were related and anticipated the redemption before the donation, because "no vote for the redemption had yet been taken" when the shareholder donated the stock. As in Palmer, the redemption in this case was not a fait accompli at the time of the gift.

The most recent case dealing with the assignment of income is Estate of Scott M. Hoensheid v. Commissioner, T.C. Memo. 2023-34, which perhaps brings some clarity – but not welcome clarity as it turns out – for taxpayers and charitable donees. In a nutshell, the IRS argued, and the Tax Court agreed, that the bright line test of Palmer and Rev. Rul. 78-197, apply only where stock is being redeemed from a charity by a company. The opinion states:

> The anticipatory assignment of income doctrine is a longstanding "first principle of income taxation." *Commissioner v. Banks*, 543 U.S. 426, 434 (2005) (quoting *Commissioner v. Culbertson*, 337 U.S. 733, 739– 40 (1949)). The doctrine recognizes that income is taxed "to those who earn or otherwise create the right to receive it," *Helvering v. Horst*, 311 U.S. 112, 119 (1940), and that tax cannot be avoided "by anticipatory arrangements and contracts however skillfully devised," *Lucas v. Earl*, 281 U.S. 111, 115 (1930). A person with a fixed right to receive income from property thus cannot avoid taxation by arranging for another to gratuitously take title before the income is received. *See Helvering v. Horst*, 311 U.S. at 115–17; *Ferguson*, 108 T.C. at 259. This principle is applicable, for instance, where a taxpayer gratuitously assigns wage income that the taxpayer has earned but not yet received, *see Lucas v. Earl*, 281 U.S. at 114–15, or gratuitously transfers a debt instrument carrying accrued but unpaid interest, *see Austin v. Commissioner*, 161 F.2d 666, 668 (6th Cir. 1947), *aff'g* 6 T.C. 593 (1946).
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> ***
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> We must also initially address the role of the Commissioner's prior issued guidance, which petitioners have raised. In *Rauenhorst v. Commissioner*, 119 T.C. 157, 173 (2002), we held that, "[u]nder the circumstances" of that case, the Commissioner was bound not to argue against his own subregulatory guidance, as expressed in Rev. Rul. 78-197, 1978-1 C.B. 83.[21] In *Rauenhorst*, we treated Rev. Rul. 78-197 as a binding concession by the Commissioner that precluded him from relying in that case on factors other than the donee's obligation to sell contributed property in his anticipatory assignment argument.
>
> However, we also recognized in *Rauenhorst*, 119 T.C. at 171, the axiom that "revenue rulings are not binding on this Court, or other Federal courts." *See Dickinson*, T.C. Memo. 2020-128, at *10 ("This Court has not adopted Rev. Rul. 78-197 as the test for resolving anticipatory assignment of income issues and does not do so today." (citations omitted)). For a taxpayer to rely on a revenue ruling, the facts of the taxpayer's transaction must be "substantially the same as those considered in the revenue ruling." *Barnes Grp., Inc. v. Commissioner*, T.C. Memo. 2013-109, at *37–38, *aff'd*, 593 F. App'x 7 (2d Cir. 2014); *see Syzygy Ins.*

> *Co. v. Commissioner*, T.C. Memo. 2019-34, at *47–48; *see also* Statement of Procedural Rules, 26 C.F.R. § 601.601(d)(2)(v)(*a*), (*e*). On the particular facts of this case, we do not find respondent's arguments to be sufficiently contrary to Rev. Rul. 78-197 to constitute a disavowal of his published guidance. *See* Rev. Rul. 78-197, 1978-1 C.B. at 83 (describing its application as only to "proceeds of a redemption of stock under facts similar to those in *Palmer*"); *cf. Rauenhorst*, 119 T.C. at 182–83 (focusing on Commissioner's argument that courts are not bound by revenue rulings and his reliance on a case[22] that had been distinguished by the Commissioner in a prior private letter ruling).
>
> While we consider a donee's legal obligation to sell as "significant to the assignment of income analysis," *Ferguson*, 108 T.C. at 259, it "is only one factor to be considered in ascertaining the 'realities and substance' of the transaction," *Allen*, 66 T.C. at 348 (quoting *Jones*, 531 F.2d at 1345). Instead, "the ultimate question is whether the transferor, of all the circumstances, had a fixed right to income in the property at the time of transfer." *Ferguson*, 108 T.C. at 259; *see Dickinson*, T.C. Memo. 2020-128, at *10. We thus took to several other factors that bear upon whether the sale of shares was virtually certain to occur at the time of petitioners' gift. In this case the relevant factors include (1) any legal obligation to sell by the donee, (2) the actions already taken by the parties to effect the transaction, *see Ferguson*, 106 T.C. at 264, (3) the remaining unresolved transactional contingencies, *see Robert L. Peterson Irrevocable Tr. #2 v. Commissioner*, T.C. Memo. 1986-267, 51 T.C.M. (CCH) 1300, 1316, *aff'd sub nom. Peterson v. Commissioner*, 822 F.2d 1093 (8th Cir. 1987), and (4) the status of the corporate formalities required to finalize the transaction, *see Estate of Applestein*, 80 T.C. at 345–46.
>
> [Footnote 21 - In Rev. Rul. 78-197, 1978-1 C.B. at 83, in the wake of our decision in *Palmer v. Commissioner*, 62 T.C. 684 (1974), *aff'd on other issue*, 523 F.2d 1308 (8th Cir. 1975), the Commissioner advised that, "under facts similar to those in *Palmer*," he would treat a charitable contribution of stock followed by a redemption as an anticipatory assignment of income "only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption." *Palmer* involved a taxpayer's contribution of shares of stock in his controlled corporation to a charitable foundation of which he was a trustee, followed by a redemption of the shares by the corporation.]
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> [Footnote 22 - *Blake v. Comm* , 480–81 (2d Cir. 1982) (declining to rely on Rev. Rul. 78-197), *aff'g* T.C. Memo. 1981-579.]

So, what standard does the Tax Court apply?

> We apply a two-part test when determining whether to respect the form of a charitable contribution of appreciated property followed by a sale by the donee. The donor must (1) give the appreciated property away absolutely and divest of title (2) "before the property gives rise to income by way of a sale." *Humacid Co. v. Commissioner*, 42 T.C. 894, 913 (1964). The first prong incorporates the section 170(c) requirement that the taxpayer make a valid gift of property, *see Jones v. Commissioner*, 129 T.C. 146, 150 (2007), *aff'd*, 560 F.3d 1196 (10th Cir. 2009), while the second prong incorporates the anticipatory assignment of income doctrine, *see Dickinson*, T.C. Memo. 2020-128, at *8. Accordingly, we first must determine whether petitioners made a valid gift of the CSTC shares to Fidelity Charitable and, if so, on what date the gift was made. We must then determine the tax consequences, including eligibility for a charitable contribution deduction, of any gift by petitioners.

On the facts, the court found about a one month gap between when the taxpayer said the gift was made and when it was made:

> We start with petitioner's contemporaneous emails and the contemporaneous transactional documents, which we consider to be especially probative evidence with respect to his intent. On June 1, petitioner first expressed in an email that he wanted to wait to make the gift of the shares to Fidelity Charitable until the last possible moment, when he was "99% sure" that the sale to HCI would close. Petitioner's subsequent actions and communications were consistent with that intent. On June 11, petitioner and his two brothers executed the Consent to Assignment agreement, an act that demonstrated petitioner's generalized future intent to make a gift. However, the Consent to Assignment cannot establish that, as of June 11, such an intent was sufficiently present and specific. *See Czarski v. Bonk*, 124 F.3d 197, 1997 WL 535773, at *4 (6th Cir. 1997) (unpublished table decision) (applying Michigan law and finding no evidence establishing purported donor's "specific intent" with respect to the particular property). On its face, the Consent to Assignment agreement failed to specify a number of shares to be contributed, suggesting that petitioner had not yet decided that key detail. Similarly, the original stock certificate, which was prepared on or sometime after June 11, failed to specify an effective date, again suggesting that a date would be decided upon later. On July 6, petitioner stated in an email that he was still "not totally sure of the shares being transferred to the charitable fund yet." That email confirms that, as of July 6, the details of the contribution were still in flux. Indeed, three days later, on July 9, Mr. Bear emailed Mr. Boland to inform him that "it looks like Scott has arrived at 1380 shares."
>
> At trial, petitioner testified that he believed the number of shares to be donated was set at 1,380 on June 11. That testimony is squarely contradicted by the Consent to Assignment agreement, petitioner's July 6 email, and Mr. Bear's July 9 email. *See, e.g.*, *Richardson v. Commissioner*, T.C. Memo. 1984-595, 49 T.C.M. (CCH) 67, 73–74 (concluding that taxpayer's characterization of date of contribution was not credible where in conflict with "documents written contemporaneously with the donation"). Petitioner also testified that his July 6 email was referring to a potential donation of a second tranche of shares, a theoretical event which apparently never took place. The record contains no evidence supporting the claim that petitioners attempted to make (or even contemplated) two separate gifts of CSTC shares. We find petitioner's self-serving testimony as to his intent to be incredible.
>
> The record does not support a finding of present intent to make a gift until July 9 when petitioner settled on a number of 1,380 shares. From that point on, petitioner took a number of actions that confirmed his present intent to transfer. On July 9 or 10 petitioner delivered the physical stock certificate to Ms. Kanski's office. Similarly, on July 10 petitioner created an online giving account with Fidelity Charitable. Taken together, these actions provide sufficient credible evidence of petitioner's intent. W , petitioner had present intent to make a gift.

The court did not find convincing evidence of delivery or acceptance before July 13. Unfortunately for the taxpayers, whatever sale contingencies existed on June 9 had disappeared – said the court – by July 13. Thus, the taxpayers were taxed as if they owned the gifted property.

But it got worse for the taxpayer. The court agreed that the acknowledgment of the state law property interest transferred to charity was adequate for contemporaneous written acknowledgment purposes. However, as so often happens the appraisal did not satisfy the "qualified appraisal" rules:

> Petitioners' appraisal is deficient with respect to several key substantive requirements. We start with Mr. Dragon's status as an appraiser. We have previously described the requirement that an appraiser be qualified as the "most important requirement" of the regulations. *Mohamed v. Commissioner*, T.C. Memo. 2012-152, 2012 WL 1937555, at *4. Respondent argues that Mr. Dragon was not a qualified appraiser, asserting that Mr. Dragon performed valuations infrequently, did not hold himself out as an appraiser, and has no certifications from a professional appraiser organization. Petitioners counter that Mr. Dragon was qualified because he has prepared "dozens of business valuations" over the course of his 20+ year career as an investment banker, including some valuations of closely held automotive businesses.
>
> Mr. Dragon's mere familiarity with the type of property being valued does not by itself make him qualified. *See, e.g.*, *Brannan Sand & Gravel Co. v. Commissioner*, T.C. Memo. 2020-76, at *9–10, *15 (finding that attorney's familiarity with type of property being valued and awareness of typical asking price was insufficient to satisfy qualified appraiser requirement). Mr. Dragon does not have appraisal certifications and does not hold himself out as an appraiser. We found Mr. Dragon's own words at trial about his appraisal experience to be particularly instructive. Mr. Dragon testified that he conducted valuations "briefly" and only "on a limited basis" before starting at FINNEA in 2014—the year before the appraisal. Mr. Dragon also testified that he now performs (presumably gratis) business valuations for prospective clients "once or twice a year" in order to solicit their business for FINNEA. We find Mr. Dragon's uncontroverted testimony sufficient to establish that he does not "regularly perform[] appraisals for which [he] receives compensation." *See* § 170(f)(11)(E)(ii)(II). Petitioners have failed to show that Mr. Dragon was a qualified appraiser.

5. **<u>Conservation Easement Controversy</u>**. The IRS has been concerned for 10 years or longer about abusive conservation easements. Many of those concerns are focused on syndicated easements, where multiple donors join together to contribute an easement on certain properties owned via an entity. Taxpayers who are not in syndicates but whose easements are defective on technical grounds are in a bit of a no-man's land. Estimates are that over 1,000 cases are docketed in Tax Court dealing with conservation easements.

In 2017, the IRS issued a prohibition on syndicated easements. Notice 2017-10 states:

> The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) are aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested. This notice alerts taxpayers and their representatives that the transaction described in section 2 of this notice is a tax avoidance transaction and identifies this transaction, and substantially similar transactions, as listed transactions for purposes of §1.6011-4(b)(2) of the Income Tax Regulations (Regulations) and §§6111 and 6112 of the Internal Revenue Code (Code).

The specific transaction covered by the Notice is described as follows:

> An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promotional materials may be oral or written. For purposes of this notice, promotional materials include, but are not limited to, documents described in §301.6112-1(b)(3)(iii)(B) of the Regulations. The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement.

The effect of the Notice is retroactive:

> Transactions entered into on or after January 1, 2010, that are the same as, or substantially similar to, the transaction described in section 2 of this notice are identified as "listed transactions" for purposes of §1.6011-4(b)(2) and §§6111 and 6112 effective December 23, 2016. Persons entering into these transactions <u>on or after January 1, 2010</u>, [emphasis added] must disclose the transactions as described in §1.6011-4 for each taxable year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax has not ended on or before December 23, 2016.
>
> Material advisors, including appraisers, who make a tax statement on or after January 1, 2010, with respect to transactions entered into on or after January 1, 2010, have disclosure and list maintenance obligations under §§6111 and 6112. See §§301.61113, 301.6112-1.
>
> For rules regarding the time for providing disclosure of a transaction described in this notice, see §§1.6011-4(e) and 301.6111-3(e). However, if, under §1.6011-4(e)(1), a taxpayer is required to file a disclosure statement with respect to a transaction described in this notice after December 23, 2016, and prior to May 1, 2017, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by May 1 (because April 30 is a Sunday). In addition, for purposes of disclosure of transactions described in this notice, the 90-day period provided in §1.6011-4(e)(2)(i) is extended to 180 days. Further, if under §301.6111-3(e), a material advisor is required to file a disclosure statement with respect to the listed transaction described in this notice by January 31, 2017, that disclosure statement will be considered to be timely filed if the taxpayer files the disclosure with the Office of Tax Shelter Analysis by May 1, 2017 (because April 30 is a Sunday).

In <u>Green Rock, LLC v. IRS</u>, _____ (11^{th} Cir. 2024) the court affirmed the District Court which had held that Notice 2017-10 was improperly promulgated. The Sixth Circuit, in <u>Mann Construction v. United States</u>, 27 F.4^{th} 1138 (6^{th} Cir. 2022), invalidated a different notice that had been issued without notice and comment.

In an AOD issued December 23, 2024 (IRB 2024-52), the IRS stated it would no longer apply Notice 2017-10. Instead, the government issued proposed regulations - REG-112916-23 (November 20, 2023), which were finalized on June 28, 2024. T.D. 9999.

Additional final regulations were issued on October 8, 2024. T.D. 10007. These regulations, like SECURE 2.0 and section 170(h)(7) only deal with syndicated easements. The Background notes:

> **I. The Proposed Regulations**
>
> On December 8, 2022, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-106134-22) in the Federal Register (87 FR 75185) proposing regulations that would identify certain syndicated conservation easement transactions and substantially similar transactions as "listed transactions" for purposes of §1.6011-4(b)(2) and sections 6111 and 6112 of the Code (proposed regulations). The provisions of the proposed regulations are explained in greater detail in the preamble to the proposed regulations. The Treasury Department and the IRS received 26 comments in response to the proposed regulations and notice of public hearing that are the subject of this final rulemaking. The comments are available for public inspection at https://www.regulations.gov or upon request. A public hearing on the proposed regulations was held by teleconference on March 1, 2023, at 10 a.m. Eastern Time, at which five speakers provided testimony.
>
> After full consideration of the comments received and the testimony provided, these final regulations adopt the proposed regulations with certain revisions described in the Summary of Comments and Explanation of Revisions.
>
> **II. Section 605 of the SECURE 2.0 Act**
>
> The SECURE 2.0 Act of 2022 (SECURE 2.0 Act), enacted as Division T of the Consolidated Appropriations Act, 2023, Public Law 117-328, 136 Stat. 4459 (December 29, 2022), was enacted just 15 days after publication of the proposed regulations. Section 605(a) of the SECURE 2.0 Act added section 170(h)(7)(A) to the Code, which provides that a contribution by a partnership (whether directly or as a distributive share of a contribution of another partnership) is not treated as a qualified conservation contribution for purposes of section 170 if the amount of such contribution exceeds 2.5 times the sum of each partner's relevant basis in such partnership, as defined in section 170(h)(7)(B). Section 170(h)(7)(F) states that the rules of section 170(h)(7) apply equally to S corporations and other pass-through entities.
>
> Section 605(a) of the SECURE 2.0 Act also added section 170(h)(7)(C) through (E) to the Code, which provide three exceptions to the general disallowance rule in section 170(h)(7)(A). Section 170(h)(7)(C) creates an exception for contributions by a pass-through entity that satisfy a three-year holding period; section 170(h)(7)(D) creates an exception for contributions made by family pass-through entities; and section 170(h)(7)(E) creates an exception for contributions made to preserve a building that is a certified historic structure (as defined in section 170(h)(4)(C)).
>
> Section 605(b) of the SECURE 2.0 Act added section 170(f)(19) to the Code, creating additional reporting requirements for any qualified conservation contribution (1) the conservation purpose of which is the preservation of any

> building which is a certified historic structure (as defined in section 170(h)(4)(C)), (2) which is made by a partnership (whether directly or as a distributive share of a contribution of another partnership), and (3) the amount of which exceeds 2.5 times the sum of each partner's relevant basis (as defined in section 170(h)(7)) in the partnership making the contribution. Section 170(f)(19)(C) states that, except as may be otherwise provided by the Secretary, the rules of section 170(f)(19) apply to S corporations and other passthrough entities in the same manner as such rules apply to partnerships.
>
> Section 170(f)(19)(A) provides that no deduction is allowed for such a contribution unless the entity making the contribution (1) includes on its return for the taxable year in which the contribution is made a statement that the entity made such a contribution and (2) provides such information about the contribution as the Secretary may require.
>
> Section 605(c) of the SECURE 2.0 Act provides that no inference is intended as to the appropriate treatment of contributions made in taxable years ending on or before the date of the SECURE 2.0 Act's enactment (December 29, 2022), or as to any contribution for which a deduction is not disallowed by reason of section 170(h)(7).
>
> On November 20, 2023, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-112916-23) in the Federal Register (88 FR 80910) proposing regulations concerning the statutory disallowance rule enacted by the SECURE 2.0 Act, including the calculation of relevant basis. On June 28, 2024, the Treasury Department and the IRS finalized these regulations in TD 9999 (89 FR 54284).

Section III of the Supplemental Information discusses why the regulations are needed even though there is a new statute:

> The Treasury Department and the IRS have concluded that it is in the interest of sound tax administration to continue to identify abusive syndicated conservation easement transactions as listed transactions, notwithstanding passage of section 605 of the SECURE 2.0 Act. However, in adopting the proposed regulations as final regulations, the Treasury Department and the IRS have made several modifications to the proposed rules, as described in this Summary of Comments and Explanation of Revisions. Thus, these final regulations are consistent with the commenters' recommendation that the final regulations take "a more surgical approach" to the definition of the syndicated conservation easement listed transaction following the enactment of section 170(h)(7).
>
> Specifically, these final regulations cover three major classes of abusive syndicated conservation easement transactions (and substantially similar transactions): (1) those that involve contributions occurring before December 30, 2022; (2) those for which a charitable contribution deduction is not automatically disallowed by section 170(h)(7); and (3) those that substitute the contribution of a fee simple interest in real property for the contribution of a conservation easement.
>
> A. <u>Transactions occurring before December 30, 2022</u>
>
> Section 170(h)(7)(A) does not apply to contributions made on or before December 29, 2022. As a result, these final regulations are necessary to obtain reporting of transactions that are the same as, or substantially similar to, syndicated

> conservation easement transactions in cases in which the conservation easements were contributed before December 30, 2022, and the taxpayers did not disclose the transaction pursuant to Notice 2017-10. Thus, these final regulations impose reporting requirements on taxpayers who had not previously disclosed their participation in transactions that are the same as, or substantially similar to, syndicated conservation easement transactions to the extent that a taxpayer's participation in the transaction occurred in one or more taxable years as to which the statute of limitations had not run as of the date these final regulations identify the transaction as a listed transaction.
>
> Some commenters contended that, since many taxpayers have already reported their transactions under Notice 2017-10, the IRS already has the information reporting targeted by the proposed regulations. The Treasury Department and the IRS agree that, in such cases, duplicative reporting under these final regulations is unnecessary. Accordingly, these final regulations explicitly provide that taxpayers who fully disclosed their participation in syndicated conservation easement transactions pursuant to Notice 2017-10 do not need to disclose again under these final regulations for any taxable years covered by the prior disclosure.
>
> B. <u>Transactions not automatically disallowed by section 170(h)(7)</u>
>
> The final regulations do not include an exception for transactions that are excluded from the automatic disallowance rule in section 170(h)(7). Of note, the SECURE 2.0 Act, which was enacted after the proposed regulations were issued, does not provide that the exceptions to section 170(h)(7)(A) contained in section 170(h)(7)(C) through (E) are also exceptions for purposes of the listed transaction rules. To the contrary, section 605(c)(2) of the SECURE 2.0 Act explicitly states: "No inference is intended as to the appropriate treatment of …any contribution for which a deduction is not disallowed by reason of section 170(h)(7) of the Internal Revenue Code of 1986, as added by this section." Thus, Congress has indicated that the fact that such transactions are not automatically disallowed does not mean that such transactions could not be abusive.
>
> There are at least two types of conservation easement transactions for which a charitable contribution deduction is not automatically disallowed by section 170(h)(7) that are appropriately considered listed transactions. First, transactions satisfying any of the three exceptions found in section 170(h)(7)(C) through (E) that also contain all the elements of a transaction identified as a listed transaction under these final regulations continue to be transactions that the Treasury Department and the IRS view as likely to be abusive. Thus, the final regulations do not include any exceptions for transactions described in section 170(h)(7)(C) through (E).
>
> Second, any syndicated conservation easement transaction for which a charitable contribution deduction is not automatically disallowed by section 170(h)(7) because the amount of the partnership's contribution does not exceed 2.5 times the sum of each partner's relevant basis in the partnership is nevertheless a listed transaction with respect to any partner who received promotional materials offering the possibility of being allocated a share of the contribution that equals or exceeds 2.5 times that partner's investment.

Independently, a committee of the American Bar Association issued a report, the <u>ABA RPTE Conservation Easement Task Force: Recommendations Regarding Conservation Easements and Federal Tax Law</u>. (Available via

SSRN at https://ssrn.com/abstract=3385453 or 53 Real Property, Trust and Estate Law Journal, Fall 2018/Winter 2019).

There are four general issues to keep in mind, two general ones for all charitable transfers and two specific to easements. The general issues are defective appraisals – those that don't meet the regulatory requirements – and the failure to give income tax basis information to the IRS as required. The specific issues are the "granted in perpetuity" requirement and the "protected in perpetuity" requirement. From the perspective of policy, the IRS appears to lack confidence in appraisers, which affects its willingness to accept valuations, and in some, perhaps many, easement holders, which affects its willingness to accept a broad interpretation of the regulatory limits. The validity of portions of the easement regulations have been questioned on procedural grounds.

Most recently, the IRS has raised a different argument in the syndicated easement cases, namely that the land subject to easement is held as inventory by the promotors. See Glade Creek Partners v. Commissioner, T.C. Memo. 2023-82; Mill Road 36 Henry v. Commissioner, T.C. Memo. 2023-129; Oconee Landing Property v. Commissioner, T.C. Memo. 2024-25.

6. Protected In Perpetuity; Validity of Regulation. In Oakbrook Land Holdings v. Commissioner, 154 T.C. No. 10 (2020), the Tax Court upheld the "protected in perpetuity" regulatory requirement. In 1983 the IRS issued a proposed regulation with a "perpetuity" requirement, and received more than 700 pages of comments. With respect to the procedural aspects of the regulation, the opinion states:

> The two aspects of the "judicial extinguishment" rule to which petitioner objects are the requirement that the donee receive a proportional share of the proceeds and the fact that the "proportionate share" formula does not account for the possibility of donor improvements. Treasury clearly considered the comments it received on the first point because it substantially revised the text of section 1.170A-14(g)(6)(ii), Income Tax Regs., in response to those comments. See supra pp. 14-15.
>
> Only one of the 90 commenters mentioned donor improvements, and it devoted exactly one paragraph to this subject. That commenter, NYLC, was concerned about facade easements on historic structures, as opposed to "perpetual open space easements," with which Treasury was chiefly concerned. See 48 Fed. Reg. at 22940. And NYLC mentioned this point to support its belief that donors of facade easements "are likely to be discouraged from making a donation," a supposition that Treasury may reasonably have discounted.
>
> In any event, "[t]he administrative record reflects that no substantive alternatives to the final rules were presented for Treasury's consideration." SIH Partners, 150 T.C. at 44; see dissenting op. p. 102 ("A comment is * * * more likely to be significant if the commenter suggests a remedy for the purported problem it identifies."). NYLC offered no suggestion about how the subject of donor improvements might be handled; it simply recommended "deletion of the entire extinguishment provision." Only one other commenter of the 13 mentioning judicial extinguishment voiced that recommendation.

Footnote 3, relevant to the dissent, states:

> Our dissenting colleague errs in relying on United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240 (2d Cir. 1977), to support his position. See dissenting op. pp. 110-113. That case involved a Food and Drug Administration (FDA) regulation establishing minimum "time, temperature, and salinity" requirements for processing fish. The Second Circuit invalidated the regulation as applied to one category of fish product, "non-vacuum-packed hot-smoked white-fish." Nova Scotia Food Prods. Corp., 568 F.2d at 253. The court first held that the FDA had "failed to disclose to interested parties the scientific data and the methodology upon which it relied." Id. at 250. "When the basis for a proposed rule is a scientific decision, the scientific material which is believed to support the rule should be exposed to the view of interested parties for their comment." Id. at 252. The court also held that the agency had failed to consider: (1) evidence that heating "certain types of fish to high temperatures will completely destroy the product," (2) the suggestion that using "nitrite and salt as additives could safely lower the high temperature otherwise required," and (3) the suggestion that different processing requirements should be established for different species of fish. Id. at 245. Here, the basis for the proposed regulation was not "a scientific decision"; Treasury relied on no undisclosed data when proposing its regulation; the two commenters who opposed the judicial extinguishment rule offered no concrete alternative suggestions; and the concerns they expressed lacked the significance of concerns about destroying the commercial viability of a product, which the Second Circuit aptly described as "vital questions" in Nova Scotia Food Prods. Corp., 568 F.2d at 252.
>
> ***
>
> The broad statements of purpose contained in the preambles to the final and proposed regulations, coupled with obvious inferences drawn from the regulations themselves, are more than adequate to enable us to perform judicial review. We find that Treasury's rationale for the judicial extinguishment rule "can reasonably be discerned and * * * coincides with the agency's authority and obligations under the relevant statute." SIH Partners, 150 T.C. at 47. We accordingly hold that Treasury satisfied all applicable APA requirements when promulgating this rule.

The court then turned to the substance, analyzed under Chevron as explained by the court:

> Having concluded that the regulation was properly promulgated, we turn to petitioner's contention that the regulation is substantively invalid. When considering a challenge to the substantive validity of a regulation, we generally employ the two-part test established by *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.,* 467 U.S. 837 (1984). The first prong of that test asks "whether Congress has directly spoken to the precise question at issue." *Id.* at 842. "If the intent of Congress is clear, that is the end of the matter." *Ibid.*
>
> Section 170(h)(5)(A) sets forth a general requirement that the conservation purpose be "protected in perpetuity." Congress does not appear to have considered the possibility that an easement might be judicially extinguished, and the statute does not address how that possibility would affect a taxpayer's ability to satisfy the "perpetuity" requirement. Congress therefore did not speak directly to the question at issue.
>
> We accordingly proceed to *Chevron* step two, which requires us to consider whether the regulation "is based on a permissible construction of the statute." *Chevron,* 467 U.S. at 843. If the statute is silent, we must give deference to the interpretation embodied in the agency's regulation unless it is "arbitrary,

> capricious, or manifestly contrary to the statute." Id. at 844; *see United States v. MeadCorp.*, 533 U.S. 218, 227 (2001). In other words we must sustain the regulation so long as it represents a "reasonable interpretation" of the law Congress enacted. *Chevron*, 467 U.S. at 844; *see SIH Partners*, 150 T.C. at 50.

The court determined that the regulation was valid under <u>Chevron</u>:

> We cannot say that the regulation's "proportionate value" approach is "arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844. Under the regulation the donee acquires "a property right, immediately vested in the donee organization," in a share of any future proceeds. Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. Needless to say, the easement might be extinguished many years after it was granted, and considerable inflation in property values might occur in the interim. If the donee's share were limited to the easement's historical FMV, its property right could be eviscerated in real dollar terms. This would allow the donor or its successors to "reap[ ] a windfall if the property is destroyed or condemned." *Carroll,* 146 T.C. at 214 (quoting *Kaufman,* 687 F.3d at 26). That outcome would be at odds with the regulation's central purpose: to ensure satisfaction of the statute's "protected in perpetuity" requirement by supplying the donee with an asset that replaces, in real terms, the easement that has been lost.
>
> ***
>
> Second, petitioner contends that the regulation is invalid because it does not permit the donee's share of the proceeds to be reduced by the value of improvements (if any) made by the donor. The regulation as proposed did not address donor improvements, and only one of 90 commenters mentioned the point. *See supra* pp. 21-22. Once again, we cannot say that the absence of a provision addressing donor improvements renders the regulation "arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844.
>
> Treasury's goal in prescribing this regulation was to ensure satisfaction of the statute's "protected in perpetuity" requirement. In effect this requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee "exclusively for conservation purposes." Sec. 170(h)(5)(A). In certain factual scenarios, reducing the donee's proceeds on account of donor improvements could frustrate this goal, especially if local land values should decline.
>
> For example, assume that a taxpayer donates an easement valued at $1 million on property valued at $2 million without the easement. The taxpayer thereafter spends $1 million improving the property. Many years later, there is an economic downturn, the easement is extinguished, and the property is sold for $2 million. Under the regulation the donee would be entitled to $1 million (half of the proceeds) and the conservation purpose would be deemed "protected in perpetuity." Sec. 170(h)(5)(A). But if improvements were carved out, the donee's share would be reduced to $500,000 or zero, depending on whether the carve-out was applied to the entire proceeds or to the donee's 50% share.
>
> NYLC, the only commenter to mention donor improvements, notably did not suggest any text to address this problem. And addressing it would have raised a host of questions: Would the donee's proceeds be reduced by improvements the donor had made before granting the easement, after granting it, or both? Would the donor get credit for improvements to the land itself (such as grading) or only for erecting structures? Would the donee's proceeds be reduced by the donor's

> cost for the improvements or by their FMV at the time the easement was extinguished? And how would the problem mentioned in the previous paragraph be solved, to prevent the donee's share from being severely reduced or even eliminated? It is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with these ancillary questions in some rational way. But that was a policy decision for Treasury, not this Court, to make.

The court thought it significant that the regulation was finalized long ago in 1986:

> The regulation petitioner challenges was promulgated in January 1986. It has never been amended. In the past 34 years Congress has amended section 170 more than 30 times, but these amendments have never suggested any disagreement with the construction of the statute that Treasury adopted in section 1.170A-14(g)(6), Income Tax Regs. This "strongly suggests that * * * [Congress] did not view Treasury's construction * * * as unreasonable or contrary to the law's purpose." *SIH Partners*, 150 T.C. at 53-54 (sustaining under *Chevron* step two a regulation that had persisted substantially unchanged for nearly 50 years).
>
> [footnote omitted]

Twelve judges signed on to the majority opinion. There was a concurrence and a dissent. The concurrence in result only by Judge Toro would have flunked the regulation under *Chevron* but disallowed the deduction because the charity did not receive all the state law property rights in the land. That opinion states:

> Oakbrook maintains that the requirement of section 170(h)(5)(A) is met so long as the donee, upon a sale or other disposition after extinguishment by judicial proceeding, would obtain an amount equal to the fair market value of the easement at the time the easement was established, subject to reduction for subsequent improvements funded exclusively by the donor. But Oakbrook's position ignores the fact that, to be eligible for a deduction under section 170(h) in the first place, a donor must grant to a donee an "interest[ ] in real property." Sec. 170(h)(2). One of the rights inherent in a real property interest (and presumably required to be transferred to the donee in order to satisfy section 170(h)(2)(C)) is the property holder's right to be compensated at fair market value upon a subsequent transfer or taking.
>
> ***
>
> The formula set out in the Deed exposes the fundamental problem for Oakbrook-under the terms of the Deed, the donee never received the type of "interest[ ] in real property" contemplated by section 170(h)(2)(C) and further protected by section 170(h)(5)(A). Put another way, by failing to convey to the donee the unrestricted right to be compensated at fair market value upon a future transfer or taking, the Deed so restricted the donee's interest as to cause it to fall outside the purview of section 170(h)(2)(C).
>
> The shortcoming inherent in the Deed also affects Oakbrook's compliance with section 170(h)(5)(A). The payment of a predetermined fixed amount would be insufficient as compensation for a right "protected in perpetuity" if the fair market value of the property had appreciated since the date the easement was granted. When a transfer of money to the donee is intended to satisfy the "perpetuity of purpose" requirement of section 170(h)(5)(A), no reasonable reading of the statute would bless the donee receiving an amount that is less than the fair market value

of its "interest[ ] in real property" as of the time of the conversion of its interest into cash.

On the other hand, Judge Toro would have invalidated the donor improvement portion of the regulation:

I begin at the same starting place--the statutory text. The statute provides a deduction for a contribution to a qualified organization of a "qualified real property interest" made "exclusively for conservation purposes." Although the statute makes clear that there can be no deduction unless the conservation purposes are "protected in perpetuity," one cannot lose track of the fact that the deduction is predicated on a "qualified real property interest" being contributed to a qualified organization. Thus, the most that a qualified organization can be entitled to receive if its "qualified real property interest" is extinguished in the future is the full value of that interest. Whatever the purpose of a contribution, that purpose may not be invoked to require the donor to give the donee, as a precondition to receiving a deduction for his contribution, a right to receive compensation properly attributed to the real property interest that the Code permits the donor to retain. A regulation interpreted to require otherwise cannot be a permissible interpretation of the statutory text before us. Under that text, the interest the donee organization must obtain in connection with a contribution is the "qualified real property interest" transferred to it. Requiring the donor to promise to turn over to the donee proceeds in excess of the fair market value of that interest is inconsistent with the statutory framework, and nothing in the "statutory purposes" compels a different conclusion. *Goldstein*, 451 F.3d at 881 (quoting Abbott Labs., 920 F.2d at 988).

The opinion of the Court admits that "[i]t is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with [the types of questions noted above] in some rational way." See op. Ct. p. 30. But the opinion of the Court overlooks the lack of a "rational" solution to those problems, by noting that "that was a policy decision for Treasury, not this Court, to make." See id. In the Court's view, "Treasury's overarching goal [in prescribing the regulation] was to guarantee that the donee, upon judicial extinguishment of the easement, would receive the full share of proceeds to which it was entitled. * * * Treasury exercised reasoned judgment by adhering to a simple rule that splits sale proceeds in a direct proportional manner." See id. p. 31.

I agree with the opinion of the Court that the donee should "receive the full share of proceeds to which it was entitled." See id.(emphasis added). But a rule interpreted to require the deed to allocate to the donee not only the proceeds attributable to its own real property interest but also a share of the proceeds attributable to the interest the Code permits the donor to retain does not " ' "fit" ' with the statutory language" and is unreasonable. Good Fortune Shipping SA v. Commissioner, 897 F.3d at 262 (quoting Goldstein, 451 F.3d at 881). Calling it a "policy decision" does not change the fact that the rule, as interpreted by the Commissioner, yields in certain circumstances a result that is entirely unreasonable and without any basis in the statute. Under Chevron, Treasury is entitled to draw lines on the page provided by Congress; Chevron does not give Treasury legislative authority to substitute a different page for the one Congress enacted into law.

Judge Toro also found the procedural part of the rulemaking defective:

> In response to the notice, Treasury received more than 700 pages of comments during the extended comment period and at least another 130 pages after the comment period had closed. A hearing on the proposed regulation was requested and was held on September 15, 1983. Thirty-seven members of the public were originally scheduled to speak at the hearing, and 30 actually spoke. The hearing lasted more than five hours, and the transcript exceeds 200 pages.
>
> A Treasury Decision adopting final regulations was published in the Federal Register on January 14, 1986. See T.D. 8069, 1986-1 C.B. 89, 51 Fed. Reg. 1496 (Jan. 14, 1986). The Treasury Decision spanned roughly 12 pages, of which approximately 10 contained the actual text of the regulations. That left just over two pages for Treasury's responses to comments and other administrative matters (for example, the Paperwork Reduction Act notice and drafting information). Put another way, Treasury used six columns of the Federal Register to address more than 700 pages of timely comments and more than 200 pages of public testimony. Those six columns were intended to cover comments on a "regulation project consisting of 10 paragraphs, 23 subparagraphs, 30 subdivisions, and 21 examples." See op. Ct. p. 24.
>
> One might wonder how an agency familiar with the D.C. Circuit's decision in Home Box Office, which by 1986 had been on the books for more than eight years, could have thought that six columns in the Federal Register sufficed to "respond[ ] to significant points raised by the public" in more than 700 pages, or how that response constituted a "dialogue" between the agency and the public contemplated by the APA as interpreted by Home Box Office and the authorities on which it relied. Home Box Office, 567 F.2d at 35-36 (fn. ref. omitted); see also PPG Indus., 630 F.2d at 466 (reiterating that the APA requires agencies "to give reasoned responses to all significant comments in a rulemaking proceeding"). Even for an agency determined to be exceedingly "concise," six columns in the Federal Register would be a tight amount of space to show "what major issues of policy were ventilated ... and why the agency reacted to them as it did." Carlson, 938 F.3d at 344 (alteration in original) (quoting Del. Dep't of Nat. Res. & Envtl. Control v. EPA, 785 F.3d 1, 17 (D.C. Cir. 2015)).
>
> But, in my view, Treasury did not think it confronted such a Herculean task. It is more likely that Treasury was simply following its historical position that the APA's procedural requirements did not apply to these types of regulations.[15] As the Treasury Decision explains, Treasury took the view that "[a]lthough a notice of proposed rulemaking which solicited public comments was issued, the * * * [IRS] concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. 553 did not apply." T.D. 8069, 1986-1 C.B. at 92. When an agency engaged in a particular rulemaking exercise believes the APA does not require it to provide notice and receive comments at all, it is not difficult to see why that agency might think that a rather brief explanation, offered as it were out of its own generosity, should be good enough.[17]
>
> The problem with this position, however, is that Treasury's conclusion that the regulation at issue here did not require notice and comment was mistaken, as the opinion of the Court correctly makes clear

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> The NYLC Comment Letter in effect countered that the proposed rule on future donor improvements was contrary to those policy decisions, would lead to inequitable results that were inconsistent with the statute, and would deter future contributions. In short, the NYLC Comment Letter offered comments that, "if adopted, would require a change in an agency's proposed rule." Home Box Office, 567 F.2d at 35 n.58. Those comments were both "relevant and significant," requiring a response. Grand Canyon, 154 F.3d at 468; accord Carlson, 938 F.3d at 343-344.
>
> Unfortunately, however, the Treasury Decision finalizing the regulations contains no such response. The Treasury Decision changed the sentence on which the Commissioner relies with respect to donor improvements as follows (with the relevant change underscored):
>
>> (1) Proposed Regulation: "For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value of the donee's property rights shall remain constant." 48 Fed. Reg. 22946.
>>
>> (2) Final Regulation: "For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant." T.D. 8069, 1986-1 C.B. at 99.
>
> But Treasury gave no explanation as to how the change addressed the concerns expressed in the NYLC Comment Letter. In short, Treasury's actions did not provide "an explanation [that] is clear enough that its 'path may reasonably be discerned.' " Encino Motorcars, 579 U.S. at ___, 136 S. Ct. at 2125 (quoting Bowman Transp., 419 U.S. at 286).[18] Nor does Treasury's action provide any insight on "what major issues of policy were ventilated ... and why the agency reacted to them as it did" on this point. Carlson, 938 F.3d at 344 (quoting Del. Dep't of Nat. Res. & Envtl. Control, 785 F.3d at 17).

Three judges agreed with portions of Judge Toro's opinion.

The dissent reviewed multiple comments to Treasury's proposed regulation and then turned to Treasury's response:

> What we hear is the chirping of crickets.
>
> The Final Rule's statement of basis and purpose shows absolutely no mention of the extinguishment-proceeds clause at all, much less any mention of the proportionate-share or improvements problems--and no reasoned response to any of the public's comments on those provisions.[9] The majority doesn't deny this, see op. Ct. pp. 23-25, and we aren't even the first court to notice: In Kaufman v. Shulman, 687 F.3d 21, 26 (1st Cir. 2012), the First Circuit was forced to guess at the apparent purpose of the section 1.170A-14(g)(6)(ii), Income Tax Regs., after noting that it "was unexplained when first promulgated."
>
> This makes the defining characteristic of section 1.170A-14(g)(6)(ii), Income Tax Regs., its utter lack of any contemporaneous explanation of its key choices--to require that donees get a fraction, rather than an absolute amount, of extinguishment proceeds and to require that they get a share of any proceeds from a donor's improvements to the property. There is no prefiguring of these choices in the legislative history or the notice of proposed rulemaking, and no explanation of them in the Final Rule. Had Treasury responded in any meaningful way to the

> comments that it received, such as those from the NYLC, neither donors and donees, nor courts, see, e.g., Oakbrook, T.C. Memo. 2020-54, at *20-*28 (highlighting the confusing nature of section 1.170A-14(g)(6), Income Tax Regs., and attempting to discern its meaning), nor the IRS, compare Priv. Ltr. Rul. 200836014 (Sept. 5, 2008) (stating that the regulation isn't violated by a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement), with Oakbrook, T.C. Memo. 2020-54, at *36 (addressing the IRS's argument that a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement is a violation of the regulation), would have to grapple with whether "proportionate value" establishes a fraction or a fixed value, or whether a donee is entitled to any extinguishment proceeds attributable to the value of improvements or rising land values. Such widespread industry confusion is precisely what APA section 553 is intended to avoid. So while we don't demand a perfect explanation for Treasury's decision making, see Bowman Transp., 419 U.S. at 286, we should demand some, see Encino Motorcars, 579 U.S. at __, 136 S. Ct. at 2125. And here, there wasn't any.

With respect to the substance, the dissent notes that *Chevron* can be applied in different ways and that Treasury now justifies the regulation on grounds different from what it did when it issued the regulation. As to this point, the dissent states:

> These seem like perfectly plausible reasons. But they are not the ones that Treasury itself offered at the time it issued the regulation. This raises another problem for the Commissioner in his defense--the Chenery rule. The Chenery rule prevents an agency from relying on *post hoc* rationalizations to defend its decision making. SEC v. Chenery Corp., 318 U.S. 80, 87 (1943) ("The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based."); see also State Farm, 463 U.S. at 50 (courts may not accept post hoc rationalizations). And Chevron step 2 is limited by Chenery. Bank of Am., N.A. v. FDIC, 244 F.3d 1309, 1319 (11th Cir. 2001) (stating that Chenery must be considered at step 2 of Chevron); see also Council for Urological Interests v. Burwell, 790 F.3d 212, 222 (D.C. Cir. 2015); America's Cmty. Bankers v. FDIC, 200 F.3d 822, 835 (D.C. Cir. 2000). We shouldn't be coming up with our own *post hoc* justifications for the reasonableness of the rule if the Commissioner's lawyers wouldn't be able to.
>
> The same problem affects our analysis of the substantive validity of this regulation under State Farm. The Sixth Circuit has warned agencies that its arguments in favor of a regulation not being "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" is likewise limited by the Chenery rule. See Atrium, 766 F.3d at 567-68 ("[T]he ground upon which an administrative order must be judged are those upon which the record discloses that its action was based." (quoting Chenery, 318 U.S. at 87)).
>
> The majority today comes up with as good a set of arguments as possible to justify the reasonableness of the regulatory choices that Treasury made when it was drafting this regulation. But Treasury didn't make them. Or at least it didn't make them in the administrative record of this regulation.

Contra Overbrook, the Eleventh Circuit delivered the taxpayer a significant victory in Hewitt v. Commissioner, 21 F.4th 1336 (11th Cir. 2021) holding that the Treasury interpretation in Treas. Reg. § 1.170A-14(g)(6)(ii) is arbitrary and capricious. The court introduces the case as follows:

> David and Tammy Hewitt seek review of the Tax Court's order determining that they were not entitled to carryover a charitable contribution deduction for the donation of a conservation easement (the "Easement"). The Tax Court concluded that the Easement did not satisfy the "protected-in-perpetuity" requirement, see I.R.C. § 170(h)(5), because the Easement deed violated the judicial extinguishment proceeds formula set forth in Treas. Reg. § 1.170A-14(g)(6)(ii). Specifically, in the event of judicial extinguishment, the Easement deed subtracts the value of post-donation improvements to the property from the extinguishment proceeds before determining the donee's share of the proceeds, which the Commissioner asserts violated § 1.170A-14(g)(6)(ii) and, thus, § 170(h)(5)'s protected-in-perpetuity requirement.
>
> On appeal, the Hewitts make several arguments as to why the Tax Court erred. They contend that the Commissioner's interpretation of § 1.170A-14(g)(6)(ii) is incorrect, as subtraction of the value of post-donation improvements from the proceeds allocated to the donee is the "better reading" of the regulation. As to this interpretation argument, we recently determined, in *TOT Property Holdings, LLC v. Commissioner*, that § 1.170A-14(g)(6)(ii) "does not indicate that any amount, including that attributable to improvements, may be subtracted out." 1 F.4th 1354, 1363 (11th Cir. 2021) (quoting *PBBM-Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193, 208 (5th Cir. 2018)).
>
> But, based on the taxpayers' concession in *TOT*, *id*. at 1362 & n.13, we did not address whether § 1.170A-14(g)(6)(ii) was procedurally valid under the Administrative Procedures Act ("APA") or substantively valid under the framework in *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984). Unlike the taxpayers in *TOT*, the Hewitts challenge the regulation's validity on appeal. Specifically, the Hewitts argue that the Commissioner's interpretation of § 1.170A-14(g)(6)(ii)—prohibiting the subtraction of the value of post-donation improvements to the property on which a conservation easement exists from the proceeds in the event of judicial extinguishment—is arbitrary and capricious for violating the procedural requirements of the APA, see 5 U.S.C. § 706, because the U.S. Treasury Department failed to respond to significant comments as to the improvements issue in promulgating the regulation. The Hewitts further argue that the regulation is substantively invalid under *Chevron* as an unreasonable interpretation of the statute.
>
> After careful review, and for the reasons explained below, we conclude that the Commissioner's interpretation of § 1.170A14(g)(6)(ii) is arbitrary and capricious and violates the APA's procedural requirements. And because we find the Commissioner's interpretation of § 1.170A-14(g)(6)(ii) to be invalid under the APA, the Easement deed's subtraction of the value of post-donation improvements from the extinguishment proceeds allocated to the donee does not violate § 170(h)(5)'s protected-in-perpetuity requirement. Accordingly, we reverse the Tax Court's order disallowing the Hewitts' carryover deduction for the conservation easement and remand for further proceedings.

The court noted that <u>TOT</u> didn't raise this issue:

> Unlike *TOT*, the Hewitts assert that Treasury failed to comply with the procedural requirements of the APA in promulgating Treas. Reg. § 1.170A-14(g)(6)(ii). Specifically, the Hewitts contend that the administrative record demonstrates that comments raising concerns with § 1.170A-14(g)(6)(ii) were filed during the rulemaking process, that those comments were "significant" such that they required a response from Treasury, and that Treasury failed to adequately respond

> to those significant comments in the final regulation's "basis and purpose" statement, in violation of the APA's procedural requirements. As such, the Hewitts contend that § 1.170A-14(g)(6)(ii), as interpreted by the Commissioner to prohibit the subtraction of the value of post-donation improvements to the easement property in the proceeds allocated to the donee in the event of judicial extinguishment, is arbitrary and capricious under the APA.

With respect to the procedure leading up to the issuance of the regulations, the opinion states:

> After a public hearing, Treasury adopted the proposed regulations with revisions. 51 Fed. Reg. at 1496. In the preamble to the final rulemaking, Treasury stated that "[t]hese regulations provide necessary guidance to the public for compliance with the law and affect donors and donees of qualified conservation contributions" and that it had "consider[ed] . . . all comments regarding the proposed amendments." *Id*. In the subsequent "Summary of Comments" section, however, Treasury did not discuss or respond to the comments made by NYLC or the other six commenters concerning the extinguishment proceeds regulation. *See id*. at 1497–98; *Oakbrook*, 154 T.C. at 188 ("The 'judicial extinguishment' provision is not among the amendments specifically addressed in the 'Summary of Comments.'"). And Treasury stated that "[a]lthough a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. [§] 553 [of the APA] did not apply." 51 Fed. Reg. at 1498.
>
> The Hewitts assert that these seven comments—in particular, NYLC's comment—were significant such that they warranted a response from Treasury in promulgating the final extinguishment proceeds regulation. In response, the Commissioner asserts that none of the thirteen comments were significant to require a response from Treasury because they did not raise any point casting doubt on the regulation's reasonableness.

The dissents in <u>Oakbrook</u> were important to the 11th Circuit:

> The *Oakbrook* decision was not unanimous. Judge Toro, in a concurring in result opinion, found that, if the proceeds regulation was read in the way proposed by the Commissioner, i.e., to bar subtraction of the value of post-donation improvements from the extinguishment proceeds, it failed to comply with the APA's procedural requirements. *See id*. at 216 (Toro, J., concurring).
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> ***
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> In his dissenting opinion, Judge Holmes reached a similar conclusion to Judge Toro on the regulation's procedural invalidity under the APA. He concluded that comments from NYLC and other organizations "were significant and [were] entitled to an agency response." *See id*. at 245 (Holmes, J., dissenting). Judge Holmes explained that Treasury's statement that it considered "all comments" was not sufficient under the APA, noting that the Federal Circuit, in *Dominion Resources, Inc. v. United States*, 681 F.3d 1313, 1319 (Fed. Cir. 2012), found a Treasury regulation procedurally invalid even though Treasury explicitly stated that "it rejected the commentators' recommendation and brief explanation in general terms of how one of the provisions worked." *Oakbrook*, 154 T.C. at 245–46 (Holmes, J., dissenting). He further explained that the final regulations at issue provided even less explanation than those in *Dominion Resources*, as Treasury failed to "even acknowledge the relevant comments or expressly state its

> disagreement with them" such that there was not even "a minimal level of analysis." *Id*. at 248 (quoting *Encino Motorcars*, 579 U.S. at 2120).

The court concluded:

> After careful consideration of the agency record before us, the several opinions in *Oakbrook* and precedent from the Supreme Court, and this Court's interpretation of procedural validity under the APA, we conclude that § 1.170A-14(g)(6)(ii)—as read by the Commissioner to prohibit subtracting the value of post-donation improvements to the easement property from the proceeds allocated to the donor and donee in the event of judicial extinguishment—is arbitrary and capricious under the APA for failing to comply with the APA's procedural requirements and is thus invalid. See §§ 553(c), 706(2)(A).
>
> Our decision in *Lloyd Noland* is instructive. In that case, the plaintiffs challenged a malpractice insurance rule related to Medicare reimbursements that was promulgated by the Secretary of Health and Human Services. 762 F.2d at 1563. In addressing the plaintiffs' challenge, we concluded that the malpractice insurance rule was procedurally inadequate under the APA; specifically, it violated § 553(c), which we explained requires an agency "to incorporate into a new rule a concise general statement of its basis and purpose." *Id*. at 1566. The Secretary had failed to respond to comments that a study the agency relied on, which contained limited data that the authors cautioned against generalizing, was unreliable. *Id*. While the Secretary asserted that the objections were irrelevant, we concluded otherwise, such that those comments formed the basis of our holding that the malpractice insurance rule was arbitrary. *Id*. at 1566, 1568. We also rejected the Secretary's argument that she addressed certain hospitals' comments based on the rule's preamble, stating that "[w]e are aware that insurance companies generally do not determine insurance rates for malpractice insurance based upon the financial status of the patients," and that "premiums are 'incurred primarily for the benefit of the total overall patient population and for the protection of facility assets.'" *Id*. at 1566. While the Secretary suggested "that drawing a conclusion contrary to the comments does not mean they were not considered," we explained that "[b]asis and purpose statements must enable the reviewing court to see the objections and why the agency reacted to them as it did" and that agencies should rebut relevant comments. *Id*. at 1566–67. Because the Secretary's response to the rule's comments were inadequate, we affirmed the district courts' invalidation of the rule. *Id*. at 1567, 1569; *cf. Encino Motorcars*, 579 U.S. at 2126–27 ("The [agency] said that, in reaching its decision, it had 'carefully considered all of the comments, analyses, and arguments made for and against the proposed changes.' . . . But when it came to explaining the 'good reasons for the new policy,' the [agency] said almost nothing. . . . [T]he [agency's] conclusory statements do not suffice to explain its decision." (first quoting 76 Fed. Reg. 18,832, 18,832 (Apr. 5, 2011), then quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009))).
>
> The Commissioner argues that *Lloyd Noland* should be distinguished because, in that case, we reviewed "a factual, evidence based rule," while the extinguishment proceeds regulation is based on Treasury's interpretation of § 170(h)(5)'s statutory protected-in perpetuity requirement. But, in *Lloyd Noland*, we did not hold that the requirement that "[b]asis and purpose statements must enable the reviewing court to see the objections and why the agency reacted to them as it did"—including responding to significant comments—only applies when there is "erroneous data or fact finding" underlying the proposed regulation, as the Commissioner suggests, and we decline to do so here.

> As in *Lloyd Noland*, in promulgating the final extinguishment proceeds regulation, Treasury failed to respond to the relevant and significant comment from NYLC as to the post-donation improvements issue. In the proposed regulations' preamble, Treasury stated that the "regulations reflect the major policy decisions made by the Congress and expressed in the[] committee reports" to the Tax Treatment Extension Act of 1980. 48 Fed. Reg. at 22,940. One of the policy decisions reflected in those "committee reports," expressly referenced by Treasury, provided that "the preservation of our country's natural resources and cultural heritage is important," that "conservation easements now play an important role in preservation efforts," and that "provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures." S. Rep. No. 96-1007, at 9 (1980). NYLC's comment recognized as much, stating that "[t]he statute was enacted by Congress to encourage the protection of our significant natural and built environment through the donation of conservation restrictions."

Of special importance was whether the comments from the New York Landmarks Conservancy were "significant." The court said they were:

> While we agree with the Commissioner that Treasury was only required to respond to *significant* comments to comply with the APA's procedural requirements, we disagree with the Commissioner's argument that NYLC's comment was not significant. The Commissioner's claim that the "primary (if not exclusive)" purpose in crafting the proceeds regulation was *only* to interpret § 170(h)(5)'s "protected-in-perpetuity" requirement is inconsistent with the committee reports Treasury purportedly relied on. As identified by NYLC, one of the purported purposes set forth in the committee reports, was to allow deductions for the donation of conservation easements to encourage donation for such easements. *See* S. Rep. No. 96-1007, at 9. And NYLC raised the post donation improvements issue, as to extinguishment proceeds, and warned that its exclusion in the regulatory scheme would discourage prospective donors from donating conservation easements. In other words, NYLC's comment was specific to, and casted doubt on, the reasonableness of the proceeds regulation in light of one of Congress's committee reports which, according to Treasury, was "reflected" in the final regulations. 48 Fed. Reg. at 22,940 ("The regulations reflect the major policy decisions made by the Congress and expressed in the[] committee reports."). Furthermore, the final regulations did not limit the purpose of the proceeds regulation in the way the Commissioner suggests. We thus decline to classify NYLC's comment as insignificant based on the Commissioner's interpretation of Treasury's primary purpose in crafting the proceeds regulation.6 *See State Farm*, 463 U.S. at 43, 50 ("'[W]e may not supply a reasoned basis for the agency's action that the agency itself has not given.' . . . [C]ourts may not accept appellate counsel's post hoc rationalizations for agency action." (quoting *Chenery*, 332 U.S. at 196)). The Commissioner additionally asserts that Treasury's revisions to the proposed proceeds regulation in the final regulation support Treasury's representation that it considered "all comments" in the final regulations' preamble. But, as the Commissioner concedes, the revisions were simply "clarifications" in response to other comments "expressing uncertainty" about the regulation's meaning "rather than substantive changes." Indeed, the proceeds regulation was revised from vesting the donee with a property right having a fair market value "that is a minimum ascertainable proportion of the fair market value to the entire property" to a fair market value "that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time." *See Oakbrook*, 154 T.C. at 188 (comparing the proposed and final proceeds regulations). But this

> revision does not provide any indication that Treasury was responding to NYLC's significant comment about the post-donation improvements issue. *See Lloyd Noland*, 762 F.2d at 1567; *Hussion*, 950 F.2d at 1554. We therefore reject this argument.

The Sixth Circuit went the other way from Hewitt and upheld the Tax Court in Oakbrook Land Holdings, LLC v. Commissioner, 28 F.4th 700 (6th Cir. 2022). With respect to the procedural adequacy of Treas. reg. § 1.170A-14 (g)(6)(ii) the court held:

> Under the APA, whenever agencies promulgate "a rule that 'intends to create new law, rights or duties'" such as this regulation does, they must engage in a process known as notice-and-comment rulemaking. *Tennessee Hosp. Ass'n v. Azar*, 908 F.3d 1029, 1042 (6th Cir. 2018) (quoting *Michigan v. Thomas*, 805 F.2d 176, 182–83 (6th Cir. 1986)). *See also* 5 U.S.C. § 553(b). There are three steps involved in this process. First, the agency must publish a "notice of proposed rulemaking" in the Federal Register. 5 U.S.C. § 553(b). Next, the agency must afford "interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments." § 553(c). Finally, "[a]fter consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose." *Id*
>
> The petitioners contend that the agency deviated from the APA's notice and comment requirements in two ways. First, the petitioners argue that Treasury inadequately explained the rationale for the proceeds regulation in its concise general statement of basis and purpose. Second, the petitioners argue that the agency failed to respond to certain comments about the regulation, which, according to the petitioners, raised significant issues. We consider each argument in turn.
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> 1. Adequacy of Treasury's Concise Statement of Basis and Purpose
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> After the comment period closed, Treasury issued a concise statement of basis and purpose for Treas. Reg. § 1.170A-14 that explained the regulations' goals and addressed various comments made about the rules. *See* 51 Fed. Reg. at 1497–98. This statement lacked an explanation for the policy rationale behind Treas. Reg. § 1.170A-14(g)(6)(ii) specifically. Instead, Treasury explained that the regulations contained in Treas. Reg. § 1.170A-14 "provide necessary guidance to the public for compliance with the law and affect donors and donees of qualified conservation contributions." 51 Fed. Reg. at 1496. To the petitioners, this explanation is far too succinct to provide adequate insight into the proceeds regulation's rationale. Placing this explanation within the context of the rulemaking leads us to the opposite conclusion.
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> What an agency must include in a concise general statement of basis and purpose is dictated by competing considerations. Courts, on the one hand, must be able "to see what major issues of policy were ventilated by the informal proceedings and why the agency reacted to them as it did." Simms, 45 F.3d at 1005 (quoting *Auto. Parts & Accessories Ass'n, Inc. v Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968)). Judicial scrutiny does not "contemplate that the court itself will, by a laborious examination of the record, formulate in the first instance the significant issues faced by the agency and articulate the rationale of their resolution." *Auto. Parts & Accessories Ass'n, Inc.*, 407 F.2d at 338. Agencies, on the other hand, operate

> with scarce time and limited resources. *See Vermont Yankee Nuclear Power Corp. v. Nat. Res. Defense Council, Inc.*, 435 U.S. 519, 551 (1978). These limitations mean that an agency cannot "discuss every item of fact or opinion included in the submissions made to it in informal rule making." *Simms*, 45 F.3d at 1005 (quoting *Auto. Parts & Accessories Ass'n, Inc.*, 407 F.2d at 338).
>
> Balancing these considerations, the APA's concise-general-statement requirement "is not meant to be particularly onerous." *Nat'l Mining Ass'n v. Mine Safety & Health Admin*. 512 F.3d 696, 700 (D.C. Cir. 2008). Absent an ideal statement, courts may still conduct judicial review and uphold a regulation "where the basis and purpose [are] considered obvious." *Cal-Almond, Inc. v. U.S. Dep't of Agric.*, 14 F.3d 429, 443 (9th Cir. 1993); *see also Schiller v. Tower Semiconductor Ltd.*, 449 F.3d 286, 303 (2d Cir. 2006); *Citizens to Save Spencer Cnty. v. U.S. EPA*, 600 F.2d 844, 884 (D.C. Cir. 1979). If a statement is truly concise, then "[a] careful reading of the agency's published notices, from its original grant of the petition for rulemaking to its final rule, [may still] disclose[] a 'reasoned path'" that the agency followed to reach its ultimate rule. *Simms*, 45 F.3d at 1006 (quoting *Neighborhood TV Co. v. FCC*, 742 F.2d 629, 639 (D.C. Cir. 1984)).
>
> Juxtaposing the final version of Treas. Reg. § 1.170A-14(g)(6)(ii) with the notice of proposed rulemaking reveals that the basis and purpose of the rule are apparent. In the background section of the proposed version of the proceeds regulation, Treasury provided a brief history of how the Code had treated the charitable deductions of conservation easements. 48 Fed. Reg. at 22940. This history traced how contributions of partial interests went from being disfavored under the Tax Reform Act of 1969, to being allowed under the Tax Reduction and Simplification Act of 1977. *Id*. This allowance came with a caveat: conservation easements had to "be perpetual in order to qualify for a deduction under section 170." *Id*. After Congress again amended the Code with the Tax Treatment Extension Act of 1980, Treasury proposed the proceeds regulation to implement I.R.C. § 170(h). 48 Fed. Reg. at 22940. Notably, although I.R.C. § 170(h)(5)(A) required that easements' conservation purposes be protected in perpetuity, the provision was silent about how to guarantee this requirement in the event of extinguishment. Facing this lacuna, it was obvious that Treasury would need to craft a regulation that spoke to the issue of protecting an easement's conservation purpose should unforeseen circumstances stymie this end.
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> Taken together, then, the statutory text and the legislative history that Treasury contemplated in promulgating Treas. Reg. § 1.170A-14(g)(6)(ii) illuminate the regulation's basis and purpose: to provide an administrable mechanism that would ensure that an easement's conservation purpose as per I.R.C. § 170(h)(5)(A) continued to be protected should the interest be extinguished. That the regulation allots proceeds in a manner more favorable to donees than to donors merely demonstrates Treasury's acute awareness of Congress's decision to concern itself with the welfare of one entity over the other once the donation was made. Because we can discern this from the information that Treasury provided during the rulemaking, its concise statement suffices.

The court was lenient in the requirement that Treasury respond to comments:

> In the concise general statement of basis and purpose that accompanied the final rule, Treasury also did not address any comments that touched on Treas. Reg. §

1.170A-14(g)(6)(ii). For the petitioners, this oversight is the main procedural deficiency with the rule. To this end, they list a series of comments that mentioned the proceeds regulation, argue that at least some of these required Treasury's attention, and conclude that the agency's failure to do so is fatal to the regulations. Having thoroughly examined these comments, we disagree.

The APA's requirement of soliciting comments serves several ends. "In addition to increasing the quality of rules, the required public participation helps 'ensure fair treatment for persons to be affected by' regulation." *United States v. Cain*, 583 F.3d 408, 420 (6th Cir. 2009) (quoting *Dismas Charities, Inc. v. U.S. Dep't of Justice*, 401 F.3d 666, 678 (6th Cir. 2005)). From these principles follows an agency's duty to respond to "significant points raised by the public." *Sherley v. Sebelius*, 689 F.3d 776, 784 (D.C. Cir. 2012) (quoting *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35–36 (D.C. Cir. 1977)). After all, if an agency could ignore every comment regardless of its content, then the process of soliciting public input would be pointless. *See id*.

Yet the inverse is true, too. Requiring an agency to respond to every comment regardless of its content would transform rulemaking into

> a game or a forum to engage in unjustified obstructionism by making cryptic and obscure reference to matters that "ought to be" considered and then, after failing to do more to bring the matter to the agency's attention, seeking to have that agency determination vacated on the ground that the agency failed to consider matters "forcefully presented."

Vermont Yankee, 435 U.S. at 553–54. Recognizing that notice-and-comment rulemaking is not an administrative sport, we have repeatedly concluded that an agency must "give reasoned responses to all significant comments in a rulemaking proceeding," not that an agency must respond to all comments. *United States v. Utesch*, 596 F.3d 302, 310 (6th Cir. 2010) (quoting P*PG Indus., Inc. v. Costle*, 630 F.2d 462, 466 (6th Cir. 1980)) (emphasis added); *see also Navistar Int'l Transp. Corp. v. U.S. EPA*, 941 F.2d 1339, 1359 (6th Cir. 1991).

Significance is difficult to measure in the abstract. The petitioners catalog cases that they argue use different "tests" for determining whether a comment requires an agency's response. *See, e.g., Indep. U.S. Tanker Owners Comm. v. Dole*, 809 F.2d 847, 852 (D.C. Cir. 1987); *Home Box Office, Inc.*, 567 F.2d at 35 n.58; *United States v. Nova Scotia Food Prods. Corp.*, 568 F.2d 240, 253 (2d Cir. 1977). Rather than provide discrete tests, however, these cases demonstrate that assessing significance is context dependent and requires reading the comment in light of both the rulemaking of which it was part and the statutory ends that the proposed rule is meant to serve.

"Accordingly, an agency must respond to comments 'that can be thought to challenge a fundamental premise' underlying the proposed agency decision." *Carlson v. Postal Regul. Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019) (quoting *MCI WorldCom, Inc. v. FCC*, 209 F.3d 760, 765 (D.C. Cir. 2000)). A comment must provide enough facts and reasoning to show the agency what the issue is and how it is relevant to the agency's aims. *See Vermont Yankee*, 435 U.S. at 553; *Home Box Office, Inc*., 567 F.2d at 35 n.58. Comments that do so are "significant enough to step over a threshold requirement of materiality" needed for an agency to address them. *Vermont Yankee*, 435 U.S. at 553 (quoting *Portland Cement Ass'n v. Ruckelshau*s, 486 F.2d 375, 394 (D.C. Cir. 1973)).

The court also commented on the Hewitt case:

> The petitioners also direct us to a recent decision by the Eleventh Circuit that held the proceeds regulation to be procedurally invalid under the APA. See *Hewitt v. Comm'r*, 21 F.4th 1336, 1339 (11th Cir. 2021). Unlike the concurrence, we find that decision's reasoning to be unpersuasive. In concluding that the New York Landmarks Conservancy's comment raised significant concerns about possible deterrent effects that the proceeds regulation could have on donations, the Eleventh Circuit stressed that one of I.R.C. § 170's aims is "to allow deductions for the donation of conservation easements to encourage donation for such easements." *Id*. at 1352. Although encouraging the donation of conservation easements is undeniably a goal of the statute, highlighting this point overlooks a crucial condition that Congress demanded be met by donors seeking deductions: an easement's conservation purpose must be "protected in perpetuity."7 I.R.C. § 170(h)(5)(A).
>
> That the proceeds regulation interprets I.R.C. § 170(h)(5)(A) and is meant to enforce Congress's goal of limiting deductions to those instances in which the perpetuity requirement can be satisfied is evident from the regulations. Not only does the plain language of the proceeds regulation address this end, see Treas. Reg. § 1.170A-14(g)(6)(i) ("the conservation purpose can nonetheless be treated as protected in perpetuity" if the proceeds regulation is followed upon judicial extinguishment), but the rule is also part of a section in the regulations titled "Enforceable in perpetuity," Treas. Reg. § 1.170A-14(g), that contemplates various scenarios in which the perpetuity requirement of I.R.C. § 170(h)(5)(A) would not be met, *see, e.g.*, Treas. Reg. § 1.170A-14(g)(2), id. § 1.170A-14(g)(4). Other than missing § 1.170A-14(g)(2), which regulates how mortgages impact the perpetuity requirement and was added in response to other comments, the proposed rule contained the same relevant language. *See* 48 Fed. Reg. at 22945–47. Put differently, I.R.C. § 170(h)(5)(A) embodies a particular policy that restricts deductions to where an easement's conservation purpose can be protected forever, and Treas. Reg. § 1.170A-14(g)(6)(ii) interprets how to implement that policy. The Eleventh Circuit's decision thus does not alter our conclusion that Oakbrook has failed to cite comments that raised valid concerns about how the regulation served this policy.
>
> At this point, the concurrence interjects to accuse us of treating the perpetuity requirement of I.R.C. § 170(h)(5)(A) as a trump card. But we did not decide that perpetuity should play a vital role in the statutory scheme. Congress did. Even aside from the legislative history on which Treasury expressly relied in crafting the proceeds regulation, the statute's text makes it apparent that what Congress sought to encourage is not simply the donation of conservation easements as the concurrence believes. Rather, Congress intended to incentivize the donations of only those easements that met a highly circumscribed set of prerequisites. These easements must be "of a qualified real property interest," which includes the requirement that the interest contain a perpetual restriction on its use. I.R.C. § 170(h)(1)(A), (2)(C). Donations must be "to a qualified organization." I.R.C. § 170(h)(1)(B). And, of course, they must be "exclusively for conservation purposes"—purposes that must be ensured to endure forever. I.R.C. § 170(h)(1)(C), (5)(A). *Cf. Carlson*, 938 F.3d at 342, 345–46 (noting that "simplicity of structure" was one of the "fourteen [statutory] factors" that Congress explicitly deemed it necessary for the Postal Service to contemplate in rulemaking).

The majority found the regulation was a reasonable interpretation of the statute and thus entitled to a Chevron deference holding of validity.

A concurrence in judgment concluded that the "proceeds regulation" should be invalidated but thought the Oakbrook deed violated the "perpetuity" requirement. Judge Guy's opinion is educational, especially in view of the 2024 Supreme Court's holding in Loper Bright, discussed later in these materials.

> The Department of the Treasury must play by the same rules as other federal agencies. The Supreme Court made that clear when it refused to "carve out an approach to administrative review good for tax law only" and "expressly 'recognized the importance of maintaining a uniform approach to judicial review of administrative action.'" *Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55 (2011) (cleaned up) (quoting *Dickinson v. Zurko*, 527 U.S. 150, 154 (1999)). But it seems the majority opinion has done the opposite for Treasury's proceeds regulation (Treas. Reg. § 1.170A-14(g)(6)(ii)). In my view, the regulation is procedurally invalid under the Administrative Procedure Act (APA) for substantially the same reasons stated by the Eleventh Circuit in *Hewitt v. Commissioner of IRS*, 21 F.4th 1336 (11th Cir. 2021), and by the concurring and dissenting opinions in *Oakbrook Land Holdings, LLC v. Commissioner of IRS*, 154 T.C. 180, 200-30 (2020) (Torro, J., concurring in the judgment, joined in full by Urda, J., and joined in part by Gustafson and Jones, JJ.); *id*. at 230-259 (Holmes, J., dissenting). But I would conclude that the Commissioner's statutory argument is not forfeited and affirm on that basis.
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> As the Eleventh Circuit held, NYLC's comment "was significant and required a response by Treasury to satisfy the APA's procedural requirements." *Hewitt*, 21 F.4th at 1351. Because Treasury "failed to respond to NYLC's significant comment concerning the post-donation improvements issue as to proceeds, it violated the APA's procedural requirements." *Id*. at 1353.
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> The majority opinion makes NYLC's four-page comment seem insignificant by condensing it to one sentence and omitting the most important part. *Compare* (Maj. Op. 16), *with Hewitt*, 21 F.4th at 1345 (quoting extensively from NYLC's comment). In part, NYLC's comment made the following points:
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> > 1. Most importantly, NYLC stated that the proceeds regulation "contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter. *This formula fails to take into account that improvements may be made thereafter by the owner which should properly alter the ratio*." J.A. 671 (emphasis added). NYLC drove the point home with a specific example. Suppose the owner of property worth $100,000 grants a "scenic easement" worth 10% of the value of the entire parcel, guaranteeing that the owner of Parkacre and his successors will never build high-rise buildings in order to ensure Parkacre is a place to enjoy nature and sunlight. *See* J.A. 670-71; *see also* 48 Fed. Reg. 22940, 22944-55 (May 23, 1983). The parcel owner then spends $2 million to build rental housing units on the parcel. *Id*. If the easement is later extinguished in eminent domain proceedings for the parcel, "the donee organization would be entitled . . . to 10% of the sale price of the entire parcel including the improvements," i.e., 10% of $2.1

> million. J.A. 671. "*This would obviously be undesirable to the prospective donor and would constitute a windfall to the donee organization*." *Id*. (emphasis added).
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> 2. NYLC thus contended that the proceeds regulation "contain[s] problems *of policy and practical application* so pervasive as to cause [NYLC] to recommend strongly the deletion of these provisions. *The statute was enacted by Congress to encourage the protection of our significant natural and built environment through the donation of conservation restrictions and yet, the proposed provisions would thwart the purpose of the statute by deterring prospective donors*." J.A. 670 (emphasis added)
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> 3. NYLC spoke from first-hand experience, recounting that "it is our experience that prospective donors frequently raise the question that 'perpetuity' is a long time and may impose unforeseeably heavy burdens on themselves or future owners under unforeseeable future circumstances. We find ordinarily that these concerns are mollified upon the donor's recognition that common law permits extinguishment of restrictions . . . . Obviously, the prospect of extinguishment would no longer mollify these fears if a split of proceeds under unknown circumstances would be required." J.A. 670-71.
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> 4. NYLC—a donee organization—emphasized that "[t]he value of a conservation restriction to the donee organization is not a monetary value but a philanthropic value as a device for achieving the charitable objectives of the organization," such that "the extinguishment of a conservation restriction cannot be compensated by the payment of money." J.A. 671. To that end, NYLC stated that it "would prefer to eliminate" the proceeds regulation rather than "trade on the prospect of future windfalls when restrictions are extinguished." *Id*.
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> 5. "In light of the potential inequities described," NYLC concluded by "*recommend[ing] that the proposed proceeds formula be revised to prevent such inequities," but "strongly recommend[ed] deletion of the entire extinguishment provision.*" J.A. 672 (emphasis added).

NYLC's comment was "significant": It "show[ed] why [a] mistake was of possible significance in the results." *Vt. Yankee Nuclear Power Corp. v. Nat. Res. Def. Council, Inc.*, 435 U.S. 519, 553 (1978) (quoting P*ortland Cement Ass'n v. Ruckelshaus*, 486 F.2d 375, 394 (D.C. Cir. 1973)). The comment is significant for two principal reasons.

First, NYLC's comment is significant because it showed that the regulation "would thwart" one of "the purpose[s] of the statute by deterring prospective donors." J.A. 670; *accord Hewitt*, 21 F.4th at 1351. That is, "[o]ne of the policy decisions reflected in th[e] 'committee reports,' expressly referenced by Treasury," *Hewitt*, 21 F.4th at 1351 (quoting 48 Fed. Reg. at 22940), "provided that 'the preservation of our country's natural resources and cultural heritage is important,' that 'conservation easements now play an important role in preservation efforts,' and that 'provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures.'" *Id*. (quoting S. REP. NO. 96-1007, at 9 (1980)); *see also BC Ranch II, L.P. v. Comm'r of IRS*, 867 F.3d 547, 553-54 (5th Cir. 2017).

Second, NYLC cast doubt on the reasonableness of the regulation's formula and further showed that it would "obviously" deter donors because "the regulation's proceeds formula: (1) 'contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter'; and (2) 'fail[ed] to take into account that improvements may be made thereafter by the owner which should properly alter the ratio.'" *Hewitt*, 21 F.4th at 1351 (quoting NYLC's comment); see J.A. 670-71. The majority opinion does not grapple with this second aspect of the reasoning in *Hewitt*. If it was a significant comment to suggest that an agency's uniform cook temperature for all fish should be altered to each species of fish so that the product is not destroyed, *United States v. Nova Scotia Food Prods. Corp*., 568 F.2d 240, 243, 252-53 (2d Cir. 1977); (Maj. Op. 15-16), then NYLC's comment was likewise significant because it argued that a donor's postdonation improvements "should properly alter the ratio" so that Congress's tax incentive for prospective donors is not destroyed. J.A. 671.

Treasury might have explained that post-donation improvements might cause a slight indirect increase in the value of an easement and that the donee should reap the total value *of the easement*. But Treasury did not. More importantly, Treasury left everyone to wonder: Why would the easement holder be entitled to receive a proportional percentage of the *actual value of* the donor's post-donation improvements, i.e., rental housing units or a country club and golf course? Why would the statutory tax deduction incentivize any donor to grant a conservation easement if it means the donor (and any successors) must agree to give the donee the easement proceeds *and* a proportional ratio of *any* future improvements in the event of judicial extinguishment? Or why would Treasury require that the value of separate property rights (the easement and the property burdened) always maintain a proportional value relationship when "there is commonly little, if any, relation." RESTATEMENT (FIRST) OF PROPERTY § 508 cmt. b (Am. Law. Inst. 1944). This court should not "sanction silence in the face of such vital questions." *Nova Scotia Food Prods*., 568 F.2d at 253.

The bottom line is there is no doubt that NYLC's comment "'can be thought to challenge [two] fundamental premise[s]' underlying the proposed agency decision" and Treasury failed to respond. *Carlson v. Postal Regul. Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019) (quoting *MCI WorldCom, Inc. v. FCC*, 209 F.3d 760, 765 (D.C. Cir. 2000)); *see Hewitt*, 21 F.4th at 1351-52. (*Contra* Maj. Op. 15-16 (stating the same test but a contrary conclusion). In other words, Treasury's decision is arbitrary and capricious because it "entirely failed to consider [these] important aspect[s] of the problem." *Nat'l Ass'n of Home Builders v. Defs. of Wildlife*, 551 U.S. 644, 658 (2007) (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

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Treasury was required to *explain to the public*, why post-donation improvements are not taken into account and why it balanced the competing statutory interests in favor of adopting a fixed-ratio formula. "[A]n agency may justify its policy choice by explaining why [its] policy 'is more consistent with statutory language' than alternative policies," but Treasury is not permitted to remain silent and leave it for a court to "supply a reasoned basis for the agency's decision." *Encino Motorcars*, 579 U.S. at 223 (citation omitted). (*Contra* Maj. Op. 13, 19-20, 22, 25).

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Treasury's decision to remain silent has consequences: We cannot rely on *post hoc* explanations; nor can a court offer the reasons that might have supported Treasury's decision. The majority explains why the proceeds regulation is needed to implement the statute's protected-in-perpetuity requirement and why, as a matter of policy, the division of extinguishment proceeds should be "more favorable to donees than to donors," such that the easement holder should receive a fixed ratio of the actual value of the *donor's* post-donation improvements. (Maj. Op. 13, 19-20, 22, 25). The problem is that Treasury did not provide these reasons at the time it promulgated the proceeds regulation.

"It is a 'foundational principle of administrative law' that judicial review of agency action is limited to 'the grounds that the agency invoked when it took the action.'" *Dep't of Homeland Sec.*, 140 S. Ct. at 1907 (quoting *Michigan v. EPA*, 576 U.S. 743, 758 (2015)). "It is not the role of the courts to speculate on reasons that might have supported an agency's decision. '[W]e may not supply a reasoned basis for the agency's action that the agency itself has not given.'" *Encino Motorcars*, 579 U.S. at 224 (quoting *State Farm*, 463 U.S. at 43). That also means "courts may not accept . . . counsel's *post hoc* rationalizations for agency action." *State Farm*, 463 U.S. at 50. This "rule serves important values": It promotes "agency accountability"; instills "confidence that the reasons given are not simply 'convenient litigating position[s]'"; and preserves "the orderly functioning of the process of review." *Dep't of Homeland Sec.*, 140 S. Ct. at 1909 (citations omitted).

The Commissioner's brief and the majority opinion offer a similar rationale and cite the same law review article published in 2021. (Appellee Br. 61-63; Maj. Op. 13, 22). But "[t]he functional reasons for requiring contemporaneous explanations apply with equal force regardless whether *post hoc* justifications are raised in court by those appearing on behalf of the agency or by agency officials themselves." *Dep't of Homeland Sec.*, 140 S. Ct. at 1909.

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But this does not mean Oakbrook should prevail outright. Because Oakbrook's deed calls for the donee to receive a *fixed amount* in the event of a judicial extinguishment, the deed violates the plain language of Congress's requirement that the conservation easement must be granted in perpetuity under I.R.C. § 170(h)(2)(C). (Appellee Br. 32-35, 37); *see Oakbrook*, 154 T.C. at 204-07 (Toro, J., concurring in the judgment, joined by Gustafson, Urda, and Jones, JJ.).

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With that understanding, the statute only requires a donor to give a qualified organization one right from the bundle—the right to forever prevent uses of the property in a way inconsistent with the qualified conservation purpose. *See, e.g., Hoffman Props*., 956 F.3d at 835; *Pine Mt. Pres. v. Comm'r of IRS*, 978 F.3d 1200, 1206 (11th Cir. 2020); *BC Ranch II*, 867 F.3d at 551-54. Oakbrook's deed does that. *See* J.A. 112-19. Oakbrook holds all the remaining rights.

From there, the statute requires that the easement be "granted in perpetuity," I.R.C. § 170(h)(2)(C), meaning the donee must "*hold* [that] property interest in perpetuity[.]" *Glass v. Comm'r of IRS*, 471 F.3d 698, 713 (6th Cir. 2006) (cleaned up; emphasis added). When that provision was enacted, the blackletter law of property dictated that "[u]pon the extinguishment of an easement by eminent domain, the owner of the easement is entitled to compensation *measured by the value of the easement*." RESTATEMENT (FIRST) OF PROPERTY § 508 (emphasis added); *see also id*. § 508 cmt. b ("Fair value for purposes of the award is the loss to the owner of the easement[.]"); *id*. § 566 cmt. b. Indeed, the Supreme Court "repeatedly held that just compensation normally is to be measured by 'the market value of the property *at the time of the taking* contemporaneously paid in money.'" *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1984) (emphasis added) (quoting *Olson v. United States*, 292 U.S. 246, 255 (1934)); *accord Horne v. Dep't of Agric.*, 576 U.S. 351, 368-69 (2015). Today, Tennessee follows the same rules.

Oakbrook's deed, however, limits the donee's proceeds to a fixed amount determined *at the time of the grant*. J.A. 121-22. Oakbrook admits that "'perpetuity'—as used in connection with conservation easements—draws on the term's common-law meaning and denotes only that the granted property won't automatically revert to the grantor, his heirs, or assigns." *Pine Mt. Pres.*, 978 F.3d at 1209; (Reply Br. 6). But Oakbrook's deed does not treat the donee as the holder of the easement right at the time of judicial extinguishment because the donee's easement rights are not appraised at the time of judicial extinguishment. Rather, the announcement of a judicial extinguishment effectively means the easement right reverts to Oakbrook because the donee receives a fixed amount set at the time of the grant. Accordingly, Oakbrook did not gift an easement interest "granted in perpetuity." *See* I.R.C. § 170(h)(2)(C).

In that regard, Oakbrook's deed makes this case different from *Hewitt.* There, the deed provided that, upon judicial extinguishment, the donee will receive "a fair market value determined by": (1) finding the current "fair market value of the Property unencumbered by the Easement (*minus any increase in value after the date of th[e] grant attributable to improvements*)"; and (2) multiplying that amount "by the ratio of the value of the Easement at the time of this grant to the value of the Property." *Hewitt*, 21 F.4th at 1340 (emphasis in original). While Oakbrook's deed similarly subtracts post-donation improvements, it differs because it fixes the fair market value "as of the date of th[e] Conservation Easement" grant. J.A. 121.

The only problem is that, although the Commissioner presses this statutory argument now, the Commissioner did not raise the argument before the tax court. It appears four of the tax court judges decided to raise the argument sua sponte. *See Oakbrook*, 154 T.C. at 204-07 (Toro, J., concurring in the judgment, joined by Gustafson, Urda, and Jones, JJ.). The only statutory argument the Commissioner raised was that Oakbrook's easement deed "violates I.R.C. § 170(h)(2)(C) and (h)(5)(A) because the area covered by the conservation easement is not clearly defined." J.A. 34, 39-40, 47-49. The same provisions are the basis of the Commissioner's current statutory argument.

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In terms of fairness to the tax court, *see Sheet Metal*, 21 F.4th at 356, there is a significant difference between considering an argument to reverse a trial court and considering an argument to affirm. After all, we "may affirm a decision of the district court for any reason supported by the record, including on grounds different from those on which the district court relied." *Thomas v. City of Columbus*, 854 F.3d 361, 364-65 (6th Cir. 2017) (citation omitted); *accord U.S. Postal Serv. v. Nat'l Ass'n of Letter Carriers, AFL-CIO*, 330 F.3d 747, 750 (6th Cir. 2003).

Setting aside any exception to the forfeiture rule, our court and the Supreme Court "recognize a distinction between failing to properly raise a claim before the district court and failing to make an argument in support of that claim." *United*

> *States v. Reed*, 993 F.3d 441, 453 (6th Cir. 2021) (citation omitted); *see also Citizens United v. FEC*, 558 U.S. 310, 330-31 (2010) (concluding that the argument that a case "should be overruled is 'not a new claim,'" but instead, "it is—at most—'a new argument to support what has been a consistent claim: that the FEC did not accord Citizens United the rights it was obliged to provide by the First Amendment" (cleaned up)). The Commissioners' "arguments" that Oakbrook's deed violates § 170(h)(2)(C) and (h)(5)(A) "in two different ways, by [failing to sufficiently define the conservation area] and by [failing to satisfy the perpetuity requirements], are not separate *claims*. They are, rather, separate arguments in support of a single claim—that the [deed] effects [a violation of the statute]." *Yee v. City of Escondido*, 503 U.S. 519, 534-35 (1992). "Having raised a [statutory violation] claim in the [tax] courts, therefore, [Oakbrook] could have formulated any argument [it] liked in support of that claim here." *Id*. at 535.

The Supreme Court denied certiorari in Oakbrook despite the split in circuits. Presumably, the Court may want a second Circuit Court to invalidate the regulations before taking action to resolve the issue.

Most recently, and fascinatingly, the Tax Court in a reviewed opinion, signed by seven judges, Valley Park Ranch v. Commissioner, 162 T.C. No. 6 (2024), reversed itself and decided Hewitt was right all along! The majority opinion states:

> Upon careful consideration of the Eleventh Circuit's analysis in *Hewitt* regarding the promulgation of the proceeds regulation, we are persuaded that Treasury's actions did not provide "an explanation [that] is clear enough that its 'path may reasonably be discerned.' " *Hewitt v. Commissioner*, 21 F.4th at 1349 (alteration in original) (quoting *Encino Motorcars*, 579 U.S. at 221). Treasury's action did not provide any insight on "what major issues of policy were ventilated ... and why the agency reacted to them as it did" with respect to the proceeds regulation. *See id.* (quoting *Carlson v. Postal Regul. Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019)). Absent any explanation from Treasury on why the considerations raised by NYLC and other commentators should not have been heeded, "[i]t is not the role of the courts to speculate on reasons that might have supported an agency's decision. '[W]e may not supply a reasoned basis for the agency's action that the agency itself has not given.' " *Encino Motorcars*, 579 U.S. at 224 (second alteration in original) (quoting *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43).
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> We agree with the Eleventh Circuit's conclusion that "NYLC's comment was significant and required a response by Treasury to satisfy the APA's procedural requirements." *Hewitt v. Commissioner*, 21 F.4th at 1351. The record leaves no doubt that NYLC—and others—made comments " 'that can be thought to challenge a fundamental premise' underlying the proposed agency decision." *Carlson*, 938 F.3d at 344 (quoting *MCI WorldCom, Inc.*, 209 F.3d at 765); *Oakbrook I*, 154 T.C. at 243 (Holmes, J., dissenting) (describing significant comments as those that "identify a specific and objective issue created by the language of the proposed rule and give some explanation for why that language is troublesome"); *see also supra* pp. 16–18. The preamble to the proposed regulations explained that the proposed rules "reflect the major policy decisions made by the Congress." Prop. Treas. Reg. § 1.170A-13, 48 Fed. Reg. at 22940. But the NYLC comments essentially countered that the proposed proceeds regulation was contrary to those policy decisions and offered comments that, "if adopted, would require a change in an agency's proposed rule." *Home Box Off., Inc. v. FCC*, 567 F.2d 9, 35 n.58 (D.C. Cir. 1977).

> NYLC stated that while Congress enacted the statute "to encourage the protection of [the] ... environment through the donation of conservation restrictions," the proposed regulation "would thwart the purpose of the statute by deterring prospective donors." *Hewitt v. Commissioner*, 21 F.4th at 1345; *see also supra* p. 17. NYLC noted that the regulation's structure "contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter." *Hewitt v. Commissioner*, 21 F.4th at 1345; *see also supra* p. 17. But, according to NYLC, the formula "fail[ed] to take into account that improvements may be made thereafter by the owner which should properly alter the ratio." *Hewitt v. Commissioner*, 21 F.4th at 1345.
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> NYLC expressly tied its comments both to a specific rule included in the proposed regulations and to a specific fact pattern contemplated by the proposed regulations. *Hewitt v. Commissioner*, 21 F.4th at 1348 (citing *Oakbrook I*, 154 T.C. at 224 (Toro, J., concurring in the result)). Thus, NYLC explained why the regulation contained "problems of policy and practical application" and therefore "*strongly* recommend[ed] deletion of the entire extinguishment provision." *Id.* at 1345 (alteration in original); *see supra* pp. 16–17. We therefore follow the Eleventh Circuit and hold that those comments were both "relevant and significant," requiring a response. *Hewitt v. Commissioner*, 21 F.4th at 1351; *Grand Canyon Air Tour Coal. v. FAA*, 154 F.3d 455, 468 (D.C. Cir. 1998); *accord Carlson*, 938 F.3d at 343–44.

Two judges concurred in the result, but would not have overruled Oakbrook because they believed doing so was unnecessary:

> The Solicitor General's observation in *Oakbrook* is equally apt here. Because there are alternative grounds to grant petitioner partial summary judgment, an opinion on the validity of the proceeds regulation is unnecessary to decide this case.1 The deed at issue preserves the donee's interest in the property in the event of extinguishment. The deed provides that the easement
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> > can only be terminated or extinguished, whether in whole or in part, by judicial proceedings in a court of competent jurisdiction, and the amount of the proceeds to which [the donee] shall be entitled, after the satisfaction of prior claims, from any sale, exchange, or involuntary conversion of all or any portion of the Property subsequent to such termination or extinguishment, shall be determined by the court, unless otherwise provided by State or Federal law at the time.

Four judges signed on to a dissenting opinion which states:

> I disagree with the opinion of the Court for three reasons. First, I do not think it necessary to decide the validity of Treasury Regulation § 1.170A-14(g)(6)(ii) to resolve the Cross-Motions for Partial Summary Judgment. Second, I supported the opinion of the Court in *Oakbrook I*, and I find no compelling reason to change my position. Third, the longstanding principle of stare decisis should be followed.
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> This brings us to the central question: Did the comments offered by 2 of the 90 commenters, suggesting that the extinguishment regulation "would thwart the [statutory] purpose" by disincentivizing the donation of conservation easements,

"challenge a fundamental premise" underlying the proposed regulation? *Carlson*, 938 F.3d at 344 (quoting *MCI WorldCom, Inc. v. FCC*, 209 F.3d 760, 765 (D.C. Cir. 2000)). The opinion of the Court answers this question "yes." I would answer "no," for two major reasons.

First, *Oakbrook II* was decided after the Eleventh Circuit's decision in *Hewitt.* The Sixth Circuit found the reasoning in *Hewitt* to be unpersuasive. *Oakbrook II*, 28 F.4th at 717. The Sixth Circuit disagreed with the Eleventh Circuit's conclusion that the comments at issue raised significant concerns about possible deterrent effects that regulation could have on donations and that the goal of section 170 is to allow for deductions for the donation of conservation easements to encourage donation of such easements. *Id.*; *Hewitt v. Commissioner*, 21 F.4th at 1352. The Sixth Circuit concluded that this point overlooks Congress's requirement that an easement's conservation purpose must be "protected in perpetuity." *Oakbrook II*, 28 F.4th at 717; *see* § 170(h)(5)(A).

Second, the Sixth Circuit in *Oakbrook II* supplied the correct answer to the Eleventh Circuit's argument: "Although encouraging the donation of conservation easements is undeniably a goal of the statute, highlighting this point overlooks a crucial condition that Congress demanded be met by donors seeking deductions: an easement's conservation purpose must be 'protected in perpetuity.' " *Oakbrook II*, 28 F.4th at 717. Stated differently, Congress's policy objective was not to encourage the donation of easements *regardless of their terms,* but to encourage the donation of easements *that satisfied the statutory perpetuity requirements.* By supposing that the proceeds regulation might disincentivize the donation of easements that did not comply with the statute, comments cited by the taxpayer did not "challenge a fundamental premise" underlying the proposed regulation. *Carlson*, 938 F.3d at 344.

In 21 cases between 2016 and 2021, this Court sustained the disallowance of charitable contribution deductions because the deeds of easement failed to comply with the proceeds regulation. This is not a case where Treasury failed to conduct a rulemaking, failed to hold a public hearing, or failed to solicit and consider comments. Treasury did all these things.

I agree with the Sixth Circuit in *Oakbrook II*, and I cannot overlook "Congress's decision to emphasize that a conservation easement's purpose be protected in perpetuity." *Oakbrook II*, 28 F.4th at 718. I see no reason to change my position that Treasury's lack of response to comments petitioner cited do not jeopardize the validity of the regulation. Furthermore, the Eleventh Circuit in *Hewitt* does not raise any new arguments that were not considered by this Court in *Oakbrook I*.

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I am concerned that the Court's reversing a prior position taken only four years ago and without compelling new legal argument will result in instability of the law in the area of conservation easements. Additionally, the opinion of the Court may result in challenges to regulations that have been relied upon for over 40 years. I reiterate here what I stated in my concurrence to 3M about "creat[ing] a slippery slope whereby courts would be constantly faced with determining whether comments are significant and whether the agency responded appropriately to them." *3M Co. & Subs. v. Commissioner*, No. 5816-13, 160 T.C., slip op. at 280 (Feb. 9, 2023) (Kerrigan, C.J., concurring).

7. **Conservation Easements: Non-Syndicated**. Savanna Shoals, LLC v. Commissioner, T.C. Memo. 2024-35, was a loss by the taxpayer who claimed a $23 million deduction and was awarded a $480,000 deduction plus a 40% gross valuation misstatement penalty. But, interestingly, the court was lenient in allowing substantial compliance with the appraisal rules:

> The Foster appraisal does not state the date of the donation. However, New Shoals attached Form 8283, SERLC's [the holder] acknowledgment letter, and the easement deed to its return, which all provide the donation date. Accordingly, the IRS was not significantly affected by the Foster appraisal's failure to include the date of the easement grant. Accordingly, we find that omission of the donation date does not prevent a finding that the Foster appraisal substantially complied with the qualified appraisal requirements. *See Zarlengo*, T.C. Memo. 2014-161, at *36 (finding that taxpayers substantially complied by disclosing donation date on appraisal summary); *Simmons v. Commissioner*, T.C. Memo. 2009-208, slip op. at 17–18 (same), *aff'd*, 646 F.3d 6 (D.C. Cir. 2011).
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> Respondent identifies two potential issues with respect to this requirement. He argues that the Foster appraisal does not state that the deed limits SERLC's right to transfer the easement only to other charitable organizations. We find that this omission is minor and would not preclude the IRS from evaluating the reliability of the appraisal. The Foster appraisal clearly states that New Shoals donated a conservation easement in perpetuity, and New Shoals attached the easement deed to its return. The IRS was made aware that New Shoals was claiming an easement contribution deduction and had the necessary information to ascertain whether the deed imposed the required restrictions on SERLC's right to transfer the easement.
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> Respondent also argues that the appraisal's description of the deed's use restrictions is vague. We find that the Foster appraisal adequately describes the permitted and prohibited uses of the easement property after the easement's grant.[26] Notably, while respondent raises this issue with the appraisal, he has not challenged New Shoals's easement contribution deduction on the grounds that it failed to meet statutory or regulatory requirements for use restrictions or that Shoals received a quid pro quo for the donation. We find that the Foster appraisal provided sufficient information for the IRS to determine whether Shoals overvalued the easement.
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> The appraisal states that Mr. Foster's qualifications are provided in the addenda, but the appraisal omitted the addenda. Despite this oversight, we find that the Foster appraisal provided sufficient information about his qualifications to allow the IRS to evaluate the appraisal's reliability. It states that Mr. Foster is licensed and certified to appraise conservation easements by the Licensing and Regulation Real Estate Appraisers Board of the Georgia Department of Labor and is a member of the Appraisal Institute (AI). His membership is identified with the acronym MAI. MAI membership requires a four-year bachelor's degree, a passing grade on AI's exam, and a minimum of 4,500 hours of specialized work. *See* www.appraisalinstitute.org/ai-grs-designation-requirements (last visited Mar. 20, 2024) (providing MAI designation requirements). The appraisal further states that Mr. Foster has completed AI's continuing education requirements. Mr. Foster's membership in AI ensures he was a qualified appraiser,

and the inclusion of MAI after his name sufficiently demonstrates his education and experience in valuing conservation easements.

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The Foster appraisal clearly states that Mr. Foster holds a recognized appraiser designation with the acronym MAI. An MAI designation means that he has the education and experience to perform a valuation, as membership requires education, testing, and experience. Thus, we find that the Foster appraisal substantially complied with the statutory and regulatory requirements for stating Mr. Foster's qualifications. *See Bond*, 100 T.C. at 41 (holding that the taxpayer substantially complied with the reporting requirements even though it failed to provide the appraiser's qualifications); *see also Cave Buttes, L.L.C.*, 147 T.C. at 349–50 (holding that an appraisal substantially complied where it omitted qualifications on one co-appraiser).

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Congress enacted the heightened reporting requirements "to give the IRS tools that would enable it to identify inflated charitable contribution deductions." *Belair Woods, LLC v. Commissioner*, T.C. Memo. 2018-159, at *16; *see also Brooks v. Commissioner*, T.C. Memo. 2022-122, at *17 (explaining that Congress "specifically" enacted the heightened substantiation requirements "to prevent the Commissioner from having to sleuth through the footnotes of millions of returns"). The purpose of requiring taxpayers to report cost basis, fair market value, and the amount of the deduction on an appraisal summary is "to alert the Commissioner, in advance of audit, of potential overvaluations of contributed property and thereby deter taxpayers from claiming excessive deductions in the hope that they would not be audited." *RERI Holdings I, LLC*, 149 T.C. at 16–17 (involving the taxpayer's failure to disclose its cost or adjusted basis in the donated property). "Revenue agents cannot be required to sift through dozens or hundreds of pages of complex returns looking for clues about what the taxpayer's cost basis might be." *Belair Woods*, *LLC*, T.C. Memo. 2018-159, at *20.

Respondent argues that New Shoals did not satisfy the regulatory requirements for an appraisal summary because it attached two Forms 8283 to its return that reported inconsistent information. Only pages 2 of the two versions differed. Ms. Salvati credibly testified that Gross Collins encountered problems with its return preparation software when it submitted the signed Form 8283 as a pdf attachment to New Shoals's return. Accordingly, Gross Collins prepared a computer-generated Form 8283. In an unexplained oversight, it entered incorrect information for New Shoals's adjusted basis in the donated property, the manner of the property's acquisition, the donated property's appraised value, and the amount of the deduction. Regardless of which version the IRS reviewed, it would have been clear to the IRS that New Shoals potentially overvalued the easement. The Gross Collins Form 8283 reported a basis of $37,776 and a deduction of over $22.2 million, and the Baker Donselson Form 8283 reported a basis of $1.5 million and a deduction of $23 million. Accordingly, we do not face the same concerns that we did in *Belair Woods* or *Brooks* where the taxpayers failed to disclose and overstated their bases, respectively.

Both Forms 8283 should have alerted the IRS to a potential overvaluation of the easement's fair market value. *See Oakhill Woods, LLC v. Commissioner*, T.C. Memo. 2020-24, at *12–15 (involving an appraisal summary that did not provide the taxpayer's basis); *Loube v. Commissioner*, T.C. Memo. 2020-3, at *8–9

> (involving an appraisal summary that did not provide the date on which the donated property was acquired, the cost or adjusted basis, or the appraiser's or the donee's signature). New Shoals did not hide pertinent information. Gross Collins should have been more careful to confirm that it included the correct information on the computer-generated Form 8283. However, such carelessness does not render Form 8283 inadequate to satisfy the substantiation requirements for an appraisal summary. Under the facts and circumstances of this case, we find that Shoals satisfied the statutory and regulatory requirements of an appraisal summary. We find that the careless clerical errors on the Gross Collins Form 8283 are harmless. The misstatements of the cost basis, the fair market value, and the amount of the deduction do not rise to the level of the omissions and overstatements that we have addressed in our prior caselaw.

In Buckelew Farm v. Commissioner, T.C. Memo. 2024-52, the taxpayer won the legal arguments – the easement provisions did not violate the Treasury Regulation, the appraisal and appraiser were qualified, and the substantiation requirements were met – but lost the valuation argument. The opinion summaries that argument as follows:

> Petitioner's valuation expert, Mr. Hayter, used a discounted cashflow analysis, which is a subset of the income approach, and the comparable sales method to value the Subject Property in the "before" and "after" situations, respectively. He valued the land before the granting of the conservation easement (i.e., the before value) at \$50,480,000 and at an "after" value of \$2,680,000. If petitioner's expert is correct, the conservation easement would have a fair market value of \$47,570,000.
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> Respondent's valuation expert, Mr. Ryan, used the comparable sales method to value the Subject Property in both the "before" and "after" situations. He determined a "before" value of \$7,395,000 and an "after" value of \$2,800,000. If respondent's expert is correct, the conservation easement would have a fair market value of \$4,595,000.
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> The large disparity in the parties' fair market value estimates lies in their disagreement as to the highest and best use of the Subject Property at the time the conservation easement was donated to SERLC as well as the comparable property sales used in their respective analyses. Therefore, we must determine the highest and best use of the Subject Property before the conservation easement grant and whether the comparable property sales were appropriate.
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> Notably, Mr. Hayter and Mr. Ryan, in essence, agree on the "after" value assessment of the Subject Property as being \$2,800,000 and \$2,680,000, respectively. Consequently, the dispute centers on the "before" value assessment of the Subject Property.
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> Both Mr. Hayter and Mr. Ryan began their respective highest and best use analyses by considering whether the potential use of the Subject Property was (1) legally permissible, (2) physically possible, (3) financially feasible, and (4) maximally productive. Mr. Hayter determined that the highest and best use before the grant of the conservation easement was the "development of a 307 lot hunting and conservation oriented residential community," while Mr. Ryan determined the highest and best use to be "continued timber production, possible agriculture, recreation (primarily hunting and fishing), and extremely low-density residential

use in conjunction with long-term speculative investment for alternative uses." All four criteria are required to be met, and it does not matter that a potential use is physically possible, financially feasible, and maximally productive if it is not legally permissible.

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Petitioner asserts that the proposed development was a legally permissible use of the Subject Property despite its zoning classification of rural residential, which allows for a development density of only one unit per five acres. Under this classification the proposed development would not be a legally permissible use of the Subject Property.

Notwithstanding the Subject Property's zoning classification, petitioner contends that the proposed development would be a legally permissible use on the basis of its contention that Mr. Pitrowski told Mr. Hayter that it was "very likely" that the Subject Property would receive rezoning and development approval. In addition, petitioner relies on the June 25, 2013, opinion letter that Mr. Pitrowski issued to Mr. Adams and Mr. Klesko stating that it is his "opinion that it is 'more likely than not' that if the [2013 Land Plan] ... were submitted to this jurisdiction for a formal approval, given the current rules and regulations as we currently understand and interpret them, the land use/subdivision plan would be approved."

However, the evidence in the record contradicts petitioner's position that the Subject Property would receive a zoning variance to allow for development in accordance with the proposed development plan. While it is true that petitioner received a letter from Mr. Pitrowski, acting in his capacity as the Jones County Zoning director, stating that rezoning was "more likely than not," Mr. Pitrowski testified that he meant that to mean "[j]ust better than 50/50 that it would happen," on the basis of the information that he was given about the proposed development at the time. The letter was not a guarantee that the Jones County Planning and Zoning Department would actually approve rezoning.

At the time he issued his letter, Mr. Pitrowski was unaware that the proposed development planned on using gravel roads and community septic. Mr. Pitrowski testified that he would not have issued the same opinion and that he would have significant concerns about the number of lots in the proposed development being served by gravel roads, which have resulted in "concerns for ambulances and life safety vehicles gaining access."

Moreover, in 2013 a community septic system with a discharge of wastewater of over 10,000 gallons per day required approval at the state level by the Georgia Environmental Protection Division. Petitioner does not contest that the proposed development would exceed 10,000 gallons per day of wastewater. Had Mr. Pitrowski been aware that community septic was going to be used, he would have had to submit the proposal to the Georgia Department of Public Health, which was not done in this case.

Given that Mr. Pitrowski did not have full knowledge of the facts surrounding the proposed development at the time he issued his letter and on the basis of his testimony at trial, it is not realistic to believe that the proposed development in its current form would have received rezoning or a zoning variance. Petitioner's expert makes an unreasonable assumption regarding the likelihood that rezoning of the Subject Property would actually be approved, an error that is fatal to his valuation conclusion.

> In sum, we have serious concerns as to whether the proposed development at the Subject Property was a legally permissible use. However, even if we are to accept that the proposed development was a legally permissible use of the Subject Property, we must also determine whether the proposed development was physically possible, financially feasible, and maximally productive. Therefore, when considering the remaining highest and best use factors, we are inclined to accept the opinions and conclusion of Mr. Ryan.
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> Mr. Ryan's "before" value is based on comparable sales data from 12 comparable properties, which he selected for having attributes that lent themselves to being developed in a manner similar to the proposed development. Moreover, Mr. Ryan selected these vacant parcels on the basis of the principle of substitution, which stands for the proposition that a hypothetical buyer will not pay more for a given property when an alternative property is available for less. This simple proposition undermines petitioner's "before" value conclusion since a willing buyer would not have paid roughly $32,600 ($50,480,000 / 1,545.79 acres) per acre for nonunique vacant land in Jones County when the price per acre for substitute properties identified by respondent's expert was between $1,602 and $4,971. Mr. Ryan likewise made qualitative adjustments to the selected properties and arrived at a per-acre value of $4,750 as appropriate for the Subject Property.
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> The substitute price for vacant land in and around Jones County reveals that petitioner's "before" value of $50,480,000 is formed on the basis of the proposed development's actually being built, and not on the basis of the value of the underlying property. Petitioner has failed to show to the Court's satisfaction that the plan for the proposed development could not be applied to Mr. Ryan's comparable properties or how the qualities or attributes of the Subject Property make it particularly unique in its state as a vacant parcel.

The court declined to impose a fraud penalty but did impose a 40% accuracy related penalty:

> The penalty amount increases from 20% to 40% in the case of a "gross valuation misstatement," which occurs when the value of the property claimed on the return exceeds 200% of the correct amount. I.R.C. § 6662(h)(1) and (2)(A)(i). The taxpayer may not rely on a reasonable cause, good-faith defense against the imposition of the section 6662(h) penalty with respect to charitable contribution properties. *See* I.R.C. § 6664(c)(3); *Chandler v. Commissioner*, 142 T.C. 279, 293 (2014). However, no penalty shall be imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds $5,000. I.R.C. § 6662(e)(2). Although an underpayment may trigger a penalty for more than one reason, the Commissioner may not impose more than one penalty on a single portion of the underpayment. Treas. Reg. § 1.6662-2(c).
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> Pursuant to a Stipulation of Settled Issues dated August 9, 2022, we find that respondent has established compliance with the procedural approval requirements of section 6751(b). Because we find the value of the Partnership's conservation easement donation to be $4,595,000, its original claimed valuation of $47,570,000 is more than 200% "of the amount determined to be the correct amount of such valuation." This triggers application of the 40% gross valuation misstatement penalty under section 6662(e)(1)(A) and (h). Consequently, we will sustain the 40% gross valuation misstatement penalty determined by respondent and need not address any potential reasonable cause defense, since none applies to this penalty. *See* I.R.C. § 6664(c)(3); *Chandler*, 142 T.C. at 293.

In Seabrook v. Commissioner, T.C. Memo. 2025-6, the taxpayer claimed a $32,581,443 deduction; the court allowed $4,718,000 and imposed the accuracy-related penalty. The government argued for no deduction because, it said, the taxpayer lacked donative intent. The court disagreed:

> The Commissioner argues that Seabrook is not entitled to a charitable contribution deduction because "[t]he external features of the transaction overwhelmingly show that [Seabrook] donated the conservation easement intending to monetize the tax deduction for its members and that the 'predominant purpose' of the easement transfer was not charitable." Resp't's Op. Br. 123. In the Commissioner's view, "[Seabrook] cannot demonstrate that it intended to donate a conservation easement in excess of the value expected to be received in return" because "[Seabrook's] intent was to receive substantial tax benefits and pass them through to the investors." *Id.* at 123–24. The Commissioner points to the significant amount of the promised tax benefits, how the transaction was marketed to potential investors, and how advisors were compensated as further evidence of the transaction's profit-orientation. In short, the Commissioner says, "the crux of this transaction was to provide tax benefits, not to engage in any charitable giving." *Id.* at 125.
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> We rejected similar donative intent arguments from the Commissioner in *J L Minerals, LLC v. Commissioner*, T.C. Memo. 2024-93, at *28, *Buckelew Farm, LLC v. Commissioner*, T.C. Memo. 2024-52, at *42, *Mill Road 36 Henry, LLC v. Commissioner*, T.C. Memo. 2023-129, at *28, and *Oconee Landing Property, LLC v. Commissioner*, T.C. Memo. 2024-25, at *37, *supplemented by* T.C. Memo. 2024-73, and we reject them again here. In *Mill Road 36 Henry, LLC*, T.C. Memo. 2023-129, at *28, we found the objective fact that a perpetual conservation easement was donated to a charitable organization defeated the Commissioner's contention as to the donor's subjective intent. Similarly, in *Oconee Landing*, T.C. Memo. 2024-25, at *38, we explained that, unlike the quid pro quo cases the Commissioner cited, any benefits to the taxpayer from contributing the easement were provided not by the recipient of the easement, but by the U.S. Treasury. As we said there, "[the Commissioner] has cited, and we have discovered, no case in which the tax benefits associated with a charitable contribution deduction have been deemed a 'quid pro quo' that negates the donor's charitable intent." *Id.* We agree with the reasoning of our prior cases and adopt it here.

The court also found the appraiser to be "qualified" and the appraisal, after a fashion, to meet the requirements. But disagreed on the substance of the values. See also Ranch Springs, LLC v. Commissioner, 164 T.C. No. 6 (2025), agreeing that the appraisal was qualified but finding an easement value of $335,000 as opposed to the taxpayer's claimed value of $25,814,000, and imposing the gross valuation penalty, where the taxpayer made an interesting valuation argument relating to a potential limestone quarry on the property, which would be prevented by the easement. The question was whether the value of the easement was what was given up, or what a willing buyer would pay. The opinion states:

> In suggesting that the "willing buyer/willing seller" definition is inapplicable here, petitioner relies on a sentence in Treasury Regulation § 1.170A-14(h)(3)(i), which addresses valuation of conservation easements. That sentence reads as follows: "The value of the contribution under section 170 in the case of a charitable contribution of a perpetual conservation restriction is *the fair market value of the perpetual conservation restriction* at the time of the contribution." *Ibid.* (emphasis added by petitioner).

According to petitioner, “the fair market value of the perpetual conservation restriction” is the value of what the donor gives up by granting the easement, i.e., the value of “the property rights sacrificed.” In this case, petitioner says, the “the property rights sacrificed” consist of the right to construct and operate a limestone quarry on the land. The NPV of the hypothetical limestone quarry, petitioner concludes, is thus the FMV of the easement. On this theory, it does not matter what a knowledgeable willing buyer would pay for the land unencumbered by the easement. The “willing buyer/willing seller” test thus goes out the window.

This argument is wholly unconvincing. The sentence on which petitioner relies functions as the preamble to Treasury Regulation § 1.170A-14(h)(3)(i). It says that “[t]he value of the contribution ... in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction.” If we replace “perpetual conservation restriction” with “X,” this sentence says that “the value of the contribution ... in the case of a charitable contribution of X is the fair market value of X.”

This sentence, in other words, simply says that the value of the contribution is equal to the FMV of the property contributed. This is essentially a truism. What matters is *how we determine* the FMV of the property contributed, i.e., the value of the perpetual conservation restriction.

The sentence on which petitioner relies provides no help in answering the latter question, but the rest of the regulation does. It says that, if a live market for conservation easements exists, we look to data from that market to enable a *direct valuation* of the perpetual conservation restriction. Treas. Reg. § 1.170A-14(h)(3). In the absence of such data (as here), the regulation instructs us that the “before and after” method must generally be used to value that restriction. *Ibid.* In essence, this method values the easement indirectly rather than directly.

The “before and after” method instructs us to determine the FMV of the subject property—here, the undeveloped land—at two points in time: immediately before and immediately after the easement is granted. In determining the FMV of that property at each point, we are required to use the “willing buyer/willing seller” formula, as we would do in determining the FMV of any property for charitable contribution purposes. The first sentence of Treasury Regulation § 1.170A-14(h)(3)(i) does not “supersede” or render irrelevant the “willing buyer/willing seller” test. To the contrary, that regulation dictates a method—the “before and after” method—that requires use of the “willing buyer/willing seller” definition to determine the FMV of the property at both points in time.

There is no textual or logical support for petitioner's assertion that the “willing buyer/willing seller” formula, which governs the determination of property value for charitable contributions generally, somehow does not apply when the donated property is a conservation easement. In essence, petitioner asserts that the first sentence of Treasury Regulation § 1.170A-14(h)(3)(i) mandates use of the owner-operator version of the capitalized income method when valuing a conservation easement. But the regulation cannot plausibly be interpreted to say that.

By reading this regulation to mandate use of the valuation method petitioner prefers, petitioner is begging the question. The only valuation method the regulation specifies—applicable when there is no active market for purchase and sale of conservation easements—is the “before and after” method. Petitioner does not dispute—and its expert, Mr. Clark, agreed—that the “willing buyer/willing seller” test applies in determining the *after value* of property subject to this regulation. That being so, petitioner cannot logically contend that the same

> regulation forecloses use of the "willing buyer/willing seller" test in determining the *before value* of the same property.

8. **Proposed Regulations Dealing With Donor Advised Funds**. On November 14, 2023, Treasury issued proposed regulations under section 4966, prescribing when distributions from a donor advised fund (DAF) would be a taxable distribution. A hearing was held to receive comments on May 6-7, 2024, and voluminous written comments were submitted:

> In December 2006, the Treasury Department and the IRS issued Notice 2006–109, 2006–2 C.B. 1121, to provide interim guidance on certain requirements enacted by the PPA, including those that affect DAFs.[3] Notice 2006–109 also requested comments regarding the notice and suggestions for future guidance.
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> In February 2007, the Treasury Department and the IRS issued Notice 2007–21, 2007–1 C.B. 611, requesting comments in connection with a study conducted by the Treasury Department and the IRS on the organization and operation of DAFs and supporting organizations, as required by section 1226 of the PPA.
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> In December 2017, the Treasury Department and the IRS issued Notice 2017–73, 2017–51 I.R.B. 562, describing approaches being considered to address certain issues regarding DAFs and requesting comments on those approaches. In particular, Notice 2017–73 stated, among other things, that the Treasury Department and the IRS are considering developing proposed regulations under section 4967 that would, if finalized, provide that (1) certain distributions from a DAF that pay for the purchase of tickets that enable a donor, donor-advisor, or related person under section 4958(f)(7) to attend or participate in a charity-sponsored event result in a more than incidental benefit to such person under section 4967, and (2) certain distributions from a DAF that the distributee charity treats as fulfilling a pledge made by a donor, donor-advisor, or related person, do not result in a more than incidental benefit under section 4967 if certain requirements are met.
>
> In response to these three notices, the Treasury Department and the IRS received 118 comments, 74 of which concerned DAFs and taxable distributions.[4] After consideration of the comments received, the Treasury Department and the IRS are proposing these regulations regarding the excise taxes payable by sponsoring organizations of DAFs and fund managers on taxable distributions under section 4966. The major areas of comment relating to section 4966 are discussed in the Explanation of Provisions.

The proposed regulations would apply retroactively as of November 14, 2023, an effective date that has been sharply criticized. Two other aspects of the proposed regulations – among many others – are particularly poorly thought out. One provides that an investment advisor to a DAF could not be paid by the DAF unless the investment advisor provides investment services to the sponsoring organization as a whole. What "as a whole" means is unclear – over how many assets beyond the DAF must the advisor have investment privileges, for instance – and further comments are invited. The effect of this rule would be to penalize community foundations and privilege commercial investment houses that operate DAFs for investment purposes. Two, distributions from a DAF other than to charitable recipients or to pay investment fees would be prohibited (i.e., subject to tax). The Supplementary Information (3 – Taxable Distributions) explains as follows:

Several commenters recommended that the term "distribution" be narrowly defined to include only a gratuitous transfer. These commenters requested that a purchase of goods or services by a sponsoring organization using funds from a DAF for charitable activity or fundraising would not be considered a distribution. One commenter asked that the term "distribution" be defined the same as the term "grant" in section 4945 and that it not include payments from a sponsoring organization using funds from a DAF to vendors for goods or services or employee compensation.

The proposed regulations do not adopt these suggestions and would construe the term "distribution" broadly. In particular, the proposed regulations would provide that the term "distribution" generally means any grant, payment, disbursement, or transfer, whether in cash or in kind, from a DAF. In addition, the proposed regulations would provide that any use of DAF assets that results in a more than incidental benefit to a donor, donor-advisor, or related person is a deemed distribution and thus generally would be a taxable distribution. The Treasury Department and the IRS note that distributions resulting in a more than incidental benefit to a donor, donor-advisor, or related person may also result in tax under section 4967. *See* Notice 2017–73, 2017–51 I.R.B. 562.

However, the proposed regulations would provide that (1) investments and (2) reasonable investment and grant-related fees generally are not distributions under this definition (unless they result in a more than incidental benefit as noted above).

Investments generally would not be treated as distributions under the proposed regulations because they typically merely reflect a change from one form of property to another. The Treasury Department and the IRS would consider investments for this purpose as including both debt and equity instruments held for the purpose of obtaining income or funds, including investments made partly for charitable purposes as described in Notice 2015–62, 2015–39 I.R.B. 411. However, an investment would not, for example, include a zero-interest loan, as there is no purpose of, or provision for, obtaining income or funds from the zero-interest loan. The Treasury Department and the IRS anticipate that a zero-interest loan would be a distribution under the proposed regulations and, unless made to a section 170(b)(1)(A) organization other than a disqualified supporting organization, would require expenditure responsibility by the sponsoring organization in order not to be a taxable distribution. The Treasury Department and the IRS request comments on how to further distinguish distributions from investments.

Reasonable investment and grant-related fees paid from DAF assets generally would not be considered distributions; however, an unreasonable grant-related or investment fee would be a deemed distribution and, thus, would be a taxable distribution. The Treasury Department and the IRS expect that whether a fee is reasonable would be determined by all the facts and circumstances. For example, an expense charged uniformly or ratably across all DAFs generally would be considered a reasonable fee and not a distribution. In addition, an expense charged solely to a particular DAF (such as an expense arising from an expenditure responsibility grant from the fund) may be reasonable, depending on the facts and circumstances. However, the proposed regulations would provide that an expense charged solely to a particular DAF that is paid, directly or indirectly, to a donor, donor-advisor, or related person with respect to the DAF, is a deemed distribution subject to sections 4966, 4958, and/or 4967.

Suppose land were donated to a DAF. Fees for environmental services, surveys, and title work would be a taxable distribution. Presumably so would appraisal services. May the idiocy of such a rule be avoided if a donor contributed cash to the sponsoring organization generally, which would then pay these costs? Or would that be swept in as substantially the same?

9. Loans From Private Foundation to Disqualified Person Not Corrected By Transfer of Notes to Public Charities. ILM 202504014 dealt with loans made by a private foundation to business entities that were "founded, partially owned, and operated" by a foundation manager. The ILM concludes the loans were acts of indirect self-dealing under section 4941(d)(1)(E) of the Code. The ILM also concluded that a contribution of the notes to one or more public charities would not correct the transaction. The ILM states:

> Section 4941(e)(3) defines correction of an act of self-dealing as "undoing the transaction to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards." When an act of self-dealing involves the use of foundation property by a disqualified person, correction requires termination of the use of such property and the making of certain payments to the foundation by the disqualified person. This correction standard is illustrated by three examples in Treas. Reg. §53.4941(e)-1(c)(4)(ii). In each example, correction includes termination of the use of foundation property by the disqualified person.
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> The Foundation has proposed to correct the act of self-dealing with respect to Company 2 by assigning and distributing the Company 2 promissory notes to public charities. The effect of this distribution would be that the promissory notes would no longer be held by the Foundation and the Foundation would no longer be engaged in the extension of credit to a disqualified person. In other words, the Foundation has proposed to terminate its ownership interest in the notes so that the property used by Company 2 would no longer be "foundation property."
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> The proposed transfer of the Company 2 notes would not constitute correction as defined in Treas. Reg. §53.4941(e)-1(c)(4) because it would not result in the termination of the use of property by the disqualified person. Assignment and transfer of the Company 2 promissory notes would transfer the Foundation's right to future interest and principal payments to the public charities, but the loans would still remain outstanding. Far from terminating the use of assets loaned by the Foundation to Company 2, the proposed transfer would permit Company 2 to continue to use the loaned funds until Date 3.
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> Section 4941(e)(3) requires undoing the act of self-dealing to the extent possible and placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards. Transferring the Company 2 notes to public charities would not undo the loan transactions nor would it make the Foundation whole. Instead, the proposed correction appears intended to allow Company 2 to continue its use of the loans, and on a long-term basis. Consequently, this Office concludes that the Foundation's proposed transfer of the Company 2 notes would not constitute correction under section 4941(e)(3). Correction of the Company 2 loan transactions should be accomplished consistently with the principles outlined in section 4941(e)(3) and Treas. Reg. §53.4941(e)-1(c)(4). At a minimum, the Foundation's loans to Company 2 must be repaid.

Suppose a public charity loaned money to the borrower which repaid the foundation for its loans and then the foundation contributed to the public charity? Of course, why would a public charity do that?

10. **Accelerating CLAT Annuity Payments Permissible If No Present Valuing Involved**. In PLR 202432004 the IRS determined that where the trustee of a charitable lead annuity trust wanted to distribute the remaining annuity payments to charity now, with no reduction for present value, the trust would have no self-dealing (4941) or taxable expenditure (4945) and section 507(c) would not apply as if a private foundation terminated.

11. **Art Gift**. WT Art Partnership LP v. Commissioner, T.C. Memo. 2025-30 (2025), is a welcome change from the endless parade of conservation easement cases. The facts and issues were summarized by the court like this:

> Oscar Liu-Chen Tang is a prominent Chinese-born American businessman, investor, and philanthropist. For many decades he has been a generous supporter of the Metropolitan Museum of Art in New York City (Met). During the 1990s the Met was eager to enhance its collection of early Chinese paintings. Mr. Tang, who joined the Met's board of trustees in 1994, pledged to assist with this effort.
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> Curators at the Met expressed admiration for a group of early Chinese paintings owned by C.C. Wang, a New York art collector and dealer. In 1997 Mr. Tang paid $5 million to acquire 12 of these paintings through WT Art Partnership LP (WT Art). In April 1997 Mr. Tang and his family executed in favor of the Met a deed of promised gift covering 11 of the paintings. Mr. Tang's plan was to retain ownership of the paintings in WT Art for a period of time, expecting that they would **[*2]** appreciate. Meanwhile, most or all of the paintings were exhibited at the Met on temporary or permanent loan from WT Art.
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> During 2010–2012 WT Art donated five of these paintings to the Met, reporting aggregate charitable contribution deductions in excess of $73 million. WT Art attached to its tax return for each year appraisals to substantiate the reported values of the paintings. All five appraisals were prepared by China Guardian Auction Co. Ltd. (China Guardian), which at the time was the second largest art auction house in China.
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> Upon examination of WT Art's 2010–2012 returns, the Internal Revenue Service (IRS or respondent) disallowed the charitable contribution deductions in their entirety. It determined that China Guardian was not a "qualified appraiser" and that WT Art had failed to attach to its return a "qualified appraisal," as required by section 170(f)(11)(D), to substantiate gifts of property valued in excess of $500,000. In the alternative, the IRS determined that WT Art had overvalued the paintings.
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> After the docketed cases were consolidated in this Court, the parties reached agreement as to the fair market values (FMV) of four paintings. Following trial they have presented five questions for decision: (1) whether the appraisals attached to the returns were "qualified appraisals" by a "qualified appraiser"; (2) if not, whether that lapse is excused by section 170(f)(11)(A)(ii)(II), which provides that a deduction shall not be disallowed "if it is shown that the failure to meet [the qualified appraisal] requirements is due to reasonable cause and not to willful neglect"; (3) whether the FMV of *Palace Banquet*, the painting donated in 2010, was $26 million (as reported) or a lesser amount; (4) whether the value

> otherwise determined for *Palace Banquet* should be reduced by a discount for lack of marketability attributable to a "deaccession restriction" allegedly imposed on the Met; and (5) whether various accuracy-related penalties apply.

The discussion of the reasonable cause exception to the requirement of a qualified appraiser is interesting:

> The statute provides that "the term 'qualified appraiser' means an individual" who has "earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in the regulations prescribed by the Secretary." § 170(f)(11)(E)(ii)(I). The individual must "regularly perform[ ] appraisals for which the individual receives compensation" and must meet "such other requirements as may be prescribed by the Secretary in regulations or other guidance." § 170(f)(11)(E)(ii)(II) and (III). The individual must "demonstrate[ ] verifiable education and experience in valuing the type of property subject to the appraisal." § 170(f)(11)(E)(iii)(I).
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> We find that neither China Guardian nor any of its employees involved in preparing the 2010–2012 appraisals were "qualified appraisers." It is clear that China Guardian, as an entity, cannot be a "qualified appraiser." The statute explicitly states that the term qualified appraiser "means an individual" who meets certain requirements. § 170(f)(11)(E)(ii).
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> Each appraisal was signed by Ms. Wang as president of China Guardian. As far as the record reveals, Ms. Wang was an executive officer and manager of the firm. She did not testify at trial, and there is no evidence that she possessed "education and experience" in valuing ancient Chinese art. *See* § 170(f)(11)(E)(iii)(I). She therefore cannot be a "qualified appraiser."
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> Three or four employees ultimately supervised by Ms. Wang were involved in actual preparation of the appraisals. Only one of these employees testified at trial, and she was a junior member of the team. She suggested that a senior member of the team may have had "education and experience" in valuing ancient Chinese art. But because that person did not testify, we cannot conclude that his or her education or experience was "verifiable." *See* § 170(f)(11)(E)(iii)(I).
>
> Finally, a person can be a qualified appraiser only if "[t]he individual either holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis." Treas. Reg. § 1.170A-13(c)(5)(i)(A). China Guardian is an auction house. As a service to its clients, it provided estimates of the price at which artwork might sell if offered at auction (often called a "reserve estimate" or "presale estimate"). These sorts of estimates are not "appraisals." There is no evidence that China Guardian or any of its staff regularly performed appraisal services or held themselves out to the public as appraisers. Indeed, as far as the record reveals, the appraisals China Guardian performed for WT Art were the only appraisals it performed for compensation during 2010–2012.
>
> In sum, we conclude that the documents China Guardian prepared for WT Art were not "qualified appraisals" because they were not prepared by a "qualified appraiser." *See* § 170(f)(11)(E)(i) and (ii). We therefore need not reach respondent's arguments that the appraisals had substantive defects (authorship apart) that prevented them from being "qualified."
>
> ***

Evaluating all the facts and circumstances, we find that Mr. Tang entertained a good-faith belief that China Guardian was a reputable firm whose appraisals were acceptable to the IRS. In 2005 WT Art donated four paintings to the Met and secured an appraisal from London Gallery to support the values claimed. The IRS selected this return for examination and disputed the valuations placed on the four paintings. Significantly in our view, the IRS exam team did not challenge London Gallery's status as a "qualified appraiser" or the nature of its work product as a "qualified appraisal."

Mr. Tang concluded that it would be desirable to secure additional appraisals to support the value conclusions London Gallery had reached. As a knowledgeable observer of the market for early Chinese paintings, he believed that the center of gravity for high-quality auctions was shifting to China. He accordingly asked Wen Fong to recommend a Chinese firm that could supply backup appraisals.

Wen Fong was a professor of Chinese art history at Princeton University. In 2005 he was the Douglas Dillon Curator Emeritus of Asian Art at the Met, having previously served as consultative chairman of its Asian Art Department. Wen Fong had extensive personal experience with China Guardian and recommended it to Mr. Tang. Given Wen Fong's credentials and experience, Mr. Tang cannot be faulted for selecting China Guardian to supply backup appraisals.

The preparation of these initial appraisals established the process that WT Art subsequently followed. Dr. Hearn, the curator of Chinese paintings at the Met, prepared narrative descriptions of the four paintings drawn from materials in the Met's archives. He prepared evaluations of the paintings' condition, based on information in the Met's conservation files. This information, together with photographs of the four paintings and suggestions about comparable sales, was supplied to China Guardian. Given Dr. Hearn's credentials and experience, Mr. Tang reasonably believed that China Guardian was provided the information it needed to prepare a competent appraisal.

China Guardian prepared backup appraisals, and WT Art supplied them to the IRS exam team. The appraisals consisted of a cover sheet and three pages of analysis. The analysis included a detailed description of each painting, a list of publication references, and one or two comparable sales from Chinese auction houses. At no point during the 2005 examination did the exam team suggest that China Guardian was not a "qualified appraiser."

Eventually the parties reached a settlement that Mr. Tang described as involving "very little change." The record establishes that the IRS ultimately allowed a charitable contribution deduction corresponding to 90% of the aggregate value WT Art had reported on its 2005 return. Mr. Tang attributed the "smooth settlement" of that case to China Guardian's backup appraisals. He inferred that the IRS regarded China Guardian as a reputable company that produced reliable appraisals using Chinese auction house sales data.

During 2006–2008 WT Art donated two additional paintings to the Met, securing appraisals from London Gallery and China Guardian, respectively. China Guardian's appraisal resembled the backup appraisal it had prepared for use during the 2005 IRS examination, including comparable prices drawn from auction sales during 2005–2008 at four Chinese auction houses. The IRS did not initiate an examination of WT Art's 2006, 2007, or 2008 return.

When the time came to hire an appraiser for the 2010–2012 gifts, Mr. Tang again turned to China Guardian. The 2010–2012 appraisals were prepared following the

> same process that WT Art and China Guardian had used previously. Dr. Hearn and Wen Fong supplied photographs, narrative descriptions of the paintings, conservation reports about their condition, and potential comparable sales. China Guardian searched for additional sales transactions and determined which transactions to use as comparables.
>
> Mr. Tang had no expertise in tax law, and he had no knowledge of the technical regulatory requirements regarding who could be a "qualified appraiser." *See* Treas. Reg. § 1.6664-4(b)(1). But he did know the following. China Guardian was recommended to him by Wen Fong, an expert in Chinese art. Crucial information about the paintings was supplied to China Guardian by Dr. Hearn, another expert in Chinese art. At no point during the 2005 examination did the examining agents suggest that either China Guardian or London Gallery failed to meet the requirements for a "qualified appraiser." And Mr. Tang's takeaway from the ultimate resolution of the 2005 examination was that the IRS regarded China Guardian as a reputable company that produced reliable appraisals using Chinese auction house transactions as comparable sales.
>
> We have previously recognized that a taxpayer's past experience with the IRS may form the basis for a reasonable cause defense. *See Hugh Smith, Inc. v. Commissioner*, 8 T.C. 660, 676–78 (1947), *aff'd per curiam*, 173 F.2d 224 (6th Cir. 1949); *see also Haynes v. Commissioner*, T.C. Memo. 1990-135, 59 T.C.M. 107, 108; *Brown v. Commissioner*, T.C. Memo. 1989-89, 56 T.C.M. (CCH) 1388, 1390–91 (finding it reasonable for the taxpayer to rely on inferences drawn from past dealings with the Commissioner's agents), *aff'd in part*, *vacated in part*, *and remanded in part*, 916 F.2d 710 (4th Cir. 1990) (unpublished table decision); *cf. H. Fort Flowers Found., Inc. v. Commissioner*, 72 T.C. 399, 410–11 (1979) (finding it reasonable for a taxpayer to rely on a letter from an examining agent).
>
> Evaluating all the facts and circumstances, we find that WT Art had "reasonable cause" to believe that appraisals prepared by China Guardian would comply with all applicable reporting and substantiation requirements. Even if we were to accept respondent's argument that the appraisals had substantive deficiencies (authorship apart), we would still find that the reasonable cause exception applies. WT Art's failure to secure qualified appraisals is thus not fatal to the allowance of charitable contribution deductions.

The court had no difficulty ignoring the deaccession restriction because it was not legally binding:

> Respondent contends that "the Met, C.C. Wang, and Mr. Tang agreed to [a deaccession restriction] as part of the basis for the donation at the beginning." According to respondent, "[t]he promise not to deaccession the paintings ... was the entire reason that [C.C. Wang] was willing to part with the painting collection." But while C.C. Wang likely hoped and expected that his paintings would remain at the Met forever, we find no evidence that he imposed a legally binding deaccession restriction upon the museum.
>
> In the Wang Trust Agreement, executed in April 1997 between the Met and the C.C. Wang Charitable Trust, the parties expressed their understanding that the Met would "celebrate the expected gift of the paintings" by mounting an exhibition of those works, together with other works owned or previously contributed by C.C. Wang. This exhibition was to be accompanied by a catalog prepared by Dr. Hearn and a **[*36]** scholarly essay by Wen Fong. The Met also

agreed to name a gallery space the "C.C. Wang Family Gallery" and to name C.C. Wang an "honorary curator" of Chinese painting.

The Met prepared an "interdepartmental memorandum" dated May 9, 1997, which was addressed to the Met's executive director, general counsel, and Asian art curators. The memo attached a copy of the Wang Trust Agreement and explained what "the Museum is required to do" thereunder. The memo recited the conditions stated in the previous paragraph, and the Met duly honored all those conditions. The memo does not refer to, and the executed copy of the Wang Trust Agreement does not mention, any "deaccession restriction" affecting *Palace Banquet* or any of the other paintings in C.C. Wang's collection.

The principal evidence pointing in the other direction consists of statements contained in the minutes of the Met's trustee meetings. An excerpt from the minutes of the January 11, 2011, meeting, at which the trustees discussed the *Palace Banquet* donation, stated that "[t]his work is offered subject to the restriction that it is not to be deaccessioned." The minutes of the trustee meetings at which the 2011 and 2012 gifts were discussed likewise stated that "[t]hese works are offered subject to the restriction that they are not to be deaccessioned" and indicated the trustees' approval of a "request for ratification of restrictive conditions."

It is difficult to reconcile these minutes with the explicit statement in WT Art's Offers of Gift that the donations "shall not be subject to any condition or limitation." The relevant events occurred many years ago, and the evidentiary record on this point is not robust. As best we can discern, the Met appears to have made a unilateral decision that its best interests would be served by keeping *Palace Banquet* (and the other paintings at issue) in its collection indefinitely. Given the circumstances surrounding its acquisition of these works, the adoption of such a policy would not have been surprising.

The Met had been striving to enhance its collection of early Chinese paintings since 1970, when Douglas Dillon served as its president. The paintings collected by C.C. Wang were among the most impressive works available for purchase. Mr. Dillon himself acquired 25 of these paintings and donated them to the Met.

In 1996 Dr. Hearn created a "wish list" of additional works that might be acquired from C.C. Wang, which included the five paintings here at issue. These were not paintings that the Met received as random **[*37]** or unexpected gifts, but were works that it consciously and strategically set out to acquire. Given this historical background, it seems entirely plausible that the Met had no intention of ever parting with them.

Mr. Tang credibly testified that his intent in 2010 was for WT Art to donate *Palace Banquet* to the Met without restrictions. He acknowledged his expectation that the Met would keep the paintings in its collection. Indeed, his view was that "these were paintings that were never going to leave the Met." We find that this expectation was based on his awareness of the important role these works played in the Met's fulfillment of its cultural mission, not upon a legally binding deaccession restriction that he imposed on it.

If we were to assume arguendo that a legally binding deaccession restriction did exist, we would find that the resulting discount for lack of marketability would be de minimis. Mr. Conroy calculated a discount in the range of 26% to 31%. We would reject his methodology and result for several reasons.

***

The Met's Collection Policy stated that it "will honor any legal restriction, and even absent a binding legal obligation, it will not deaccession a work within 25 years of receiving it if the donor (or his representatives or heirs) objects." In effect, the Met voluntarily imposed on itself, as a courtesy to its donors, a deaccession restriction that would remain in effect for the first 25 years the donated work was in its collection. Any negative effect from a legally binding restriction, therefore, would not reduce the value of the work in the Met's hands until year 26.

In practice the Met appears to have deaccessioned high-value artwork infrequently. During its fiscal year ended June 30, 2010, the Met apparently deaccessioned artwork worth $146,400. During the previous ten years it appears to have deaccessioned annually artwork worth about $3.9 million. The record includes no evidence as to whether the deaccessioned works were paintings, as opposed to sculpture, furniture, medieval armor, or works in other media. Because Mr. Conroy's analysis did not take proper account of the Met's deaccession policy, its past practice of deaccessioning paintings, or the importance the Met placed on the *Palace Banquet* as part of its core collection, we find his analysis inapposite to the task at hand.

In sum, we find that *Palace Banquet* was not subject to a legally binding deaccession restriction. Even if it were, respondent has not supplied a plausible methodology for calculating the discount for lack of marketability that would accurately reflect the restriction. And we are convinced that, if there were a discount for lack of marketability, it would likely be de minimis on the facts of these cases. We accordingly find that the FMV of *Palace Banquet* on the contribution date was $12 million.

Similarly, as to penalties:

The existence of negligence is determined at the partnership level. *See Oakbrook Land Holdings, LLC v. Commissioner*, T.C. Memo. 2020-54, 119 T.C.M. (CCH) 1351, 1360; Treas. Reg. § 301.6221-1(c). Negligence includes any failure to "make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return which would seem to a reasonable and prudent person to be 'too good to be true' under the circumstances." Treas. Reg. § 1.6662-3(b)(1)(ii); *see Neonatology Assocs., P.A. v. Commissioner*, 299 F.3d at 233 (citing *Pasternak v. Commissioner*, 990 F.2d 893, 903 (6th Cir. 1993), *aff'g Donahue v. Commissioner*, T.C. Memo. 1991-181).

The "reasonable cause" defense applies with respect to the negligence and substantial understatement penalties. *See* § 6664(c)(1). As applicable here, the central question is whether WT Art had reasonable cause and acted in good faith with respect to the charitable contribution deductions claimed for 2011 and 2012. *See Higbee*, 116 T.C. at 449. We find that it did.

We have already determined that WT Art had reasonable cause for its failure to secure qualified appraisals. *See supra* pp. 22–25. Mr. Tang's take-away from the 2005 examination was that China Guardian's appraisals were acceptable to the IRS. China Guardian prepared the appraisals for the works donated in 2011 and 2012, and WT Art followed substantially the same process in securing those appraisals that it followed in securing the appraisal for *Palace Banquet.* We conclude that WT Art had reasonable cause during 2011 and 2012 for believing that China Guardian was a "qualified appraiser."

> During the preparation of the appraisal for *Palace Banquet*, Mr. Tang expressed some concern about the $26 million value estimate China Guardian had supplied. He had expected the valuation to be "about $11 million," and he was surprised that China Guardian's estimate had "changed so much from 10 to 12 to now 26." By contrast, there is no evidence that Mr. Tang expressed any concern about the valuations China Guardian accorded the paintings donated in 2011 and 2012. Indeed, the values it placed on those paintings, which WT Art adopted, were only 17% higher (on average) than the values to which the parties have agreed. We do not think these valuations would strike a reasonable and prudent person as " 'too good to be true' under the **[*42]** circumstances." *See* Treas. Reg. § 1.6662-3(b)(1)(ii); *see also Neonatology Assocs., P.A. v. Commissioner*, 299 F.3d at 233. We accordingly find that no accuracy-related penalty applies for 2011 or 2012.

C. SECTION 408 — IRAs AND RETIREMENT PLANS

1. Summary of Trust Planning Under SECURE Act. A so-called "conduit trust" is a trust whose terms mandate that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be immediately paid over to the current beneficiary. A conduit trust is the ultimate "see-through trust" because, when determining the amounts of RMDs distributable from a plan or IRA to the trust, one simply looks to the identity and age of the current beneficiary.

If plan or IRA benefits are payable to a conduit trust for the benefit of the employee's surviving spouse, those benefits may be paid over the annually recalculated life expectancy of the surviving spouse. Following the death of the surviving spouse, any remaining benefits will have to be paid no later than the end of the tenth year after the year of death of the surviving spouse.

If plan or IRA benefits are payable to a conduit trust for the benefit of a non-spousal EDB, those benefits may be paid over the life expectancy of the EDB without recalculation. Following the death of the non-spousal EDB, any remaining benefits will have to be paid no later than the end of the tenth year after the year of such death. The major exception to these rules, however, is that, if the non-spousal EDB is a minor child of the employee, the plan or IRA benefits payable to the conduit trust can no longer be paid over the EDB's life expectancy (without recalculation) from and after the point when that child has reached majority. From and after that time, any remaining benefits will have to be paid no later than the end of the tenth year after the year in which the child reached majority. If plan or IRA benefits are payable to a conduit trust for the benefit of a DB who is not an EDB, those benefits will have to be paid no later than the end of the tenth year after the year of the employee's death.

A so-called "accumulation trust" is a "see-through trust" whose terms do not require that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be paid over to any trust beneficiary at any particular time. A see-through trust is one that is valid under state law, irrevocable, has identifiable, human beneficiaries and as to which certain documentation is provided to the plan or IRA custodian or trustee by October 31 of the year after the employee's death. Certain beneficiaries, like a beneficiary whose interest is contingent on the death of a prior, residual beneficiary, can be disregarded (income to child for life, then remainder to grandchild, but if neither survive, to charity; charity may be ignored). Further, beneficiaries via a power of appointment exercised by September 30 of the year after the account owner's death will be designated, and likewise may be removed. Even if state law allows trust modification or decanting the identifiable requirement can be met. See Treas. Reg. Section 1.401(a)(9)-4, A-5(b) of the proposed regulations.

In general, if plan or IRA benefits are payable to an accumulation trust, those benefits will have to be paid no later than the end of the tenth year after the year of the employee's death. The exceptions to this general rule are as follows:

- If the accumulation trust is for the benefit of a disabled individual or a chronically ill individual, (two categories of EDB as defined in amended section 401(a)(9)(E)) and has multiple beneficiaries, it is an "applicable multi-beneficiary trust" ("AMBT"). Plan or IRA benefits payable to an AMBT may be paid using the life expectancy method, but it is not entirely clear whether the measuring life is that of the disabled or chronically ill individual or another beneficiary.
- If one or more beneficiaries of the accumulation trust are non-DBs:
    - If the employee dies before his or her RBD, plan or IRA benefits will have to be paid no later than the end of the fifth year after the year of the employee's death.
    - If the employee dies on or after his or her RBD, plan or IRA benefits may be paid over the employee's then remaining life expectancy without recalculation.

2. **<u>Qualified Plan and IRA Distribution Rules Conformed To SECURE Act</u>**. The IRS finalized regulations relating to required minimum distributions in T.C. 10001 (July 19, 2024); they took effect on January 1, 2025. New proposed regulations on collateral matters were issued too. REG-103529-23.

Among the most important provisions of, or results that would flow from, Prop. Reg. Section 1.401(a)(9) are the following:

- If the employee dies before the employee's RBD, the minimum required distribution rules are satisfied if the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the employee's death to a designated beneficiary, but if there is no beneficiary then the term is five years.
- If the employee dies on or after the employee's RBD, the minimum required distribution rules are satisfied only if RMDs (based on the designated beneficiary's life expectancy) are made annually starting in the year following the year of the employee's death *and* the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the employee's death. However, there is no requirement for make-up distributions for 2021-2024. In essence, in year 10 more than usual will be distributed.
- The age of majority is age 21. From and after the time an EDB has reached age 21, he or she is no longer an EBD but, rather, a DB, and all the minimum required distribution rules applicable to DBs apply.
- The terms "see-through trust," "conduit trust" and "accumulation trust," developed and used over the years by practitioners but not officially recognized by Treasury, are defined.

- Beneficiaries of a trust are determined to be DBs, or not, as follows:
    - Current beneficiaries are DBs.
    - "First-line" successor beneficiaries are DBs.
    - Those who would become beneficiaries at the death of "first-line" successor beneficiaries are DBs.
    - More remote beneficiaries are not considered.
    - Potential appointees under a power of appointment are not considered.
    - Actual appointees under a power of appointment are DBs.
- For a disabled individual to be considered an EDB, that individual must have been disabled at the employee's death.
- An accumulation trust of which a disabled or chronically ill individual is a beneficiary may receive RMDs based on that individual's life expectancy only if that individual is the only beneficiary of the trust who has any right to the employee's interest in the qualified plan or IRA until that beneficiary's death.
- An accumulation trust of which the employee's surviving spouse is a beneficiary (which would include a typical QTIP trust) may *not* receive RMDs based on the surviving spouse's life expectancy. Under these circumstances, a surviving spouse's status as an EDB is useless.
- A conduit trust may have multiple beneficiaries.
- Starting January 1, 2023, the required beginning date is 73, not 72, and on January 1, 2033, it is 75 (per the proposed regulations).

D. SECTIONS 671-678 -- GRANTOR TRUST RULES

1. Section 678 and a Presently Exercisable General Power of Appointment As A Planning Device.

Section 678 provides:

> (a) General Rule. —A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:
>
> > (1) such person has a power exercisable solely by himself to vest the corpus <u>or the income therefrom</u> in himself, or
> >
> > (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.
>
> (b) Exception Where Grantor Is Taxable. Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.
>
> [emphasis added]

Section 678(a)(2) has long been the basis for estate tax planning: a parent contributes $5000 to a trust that gives the child a 30 day withdrawal right and gives the child other powers that would have made the trust a grantor trust if the child had contributed the $5000 to the trust. The child would appear to be the owner of the entire trust (assuming that parent has no rights in the trust that would make the parent the grantor) and thus Rev. Rul. 85-13 would treat the child and the trust as the same taxpayer. Such trusts are often referred to as BDITs – Beneficiary Deemed Inheritor's Trusts – and have been the subject of wide discussion and controversy. See, e.g., Jerome M. Hesch, Lawrence Brody, Richard A. Oshins & Susan P. Rounds, *A Gift From Above: Estate Planning on a Higher Plane — The Unique Design of a BDIT Minimizes — Even Eliminates — Many Tax and Non-Tax Problems*, 150 Tr. & Est. 17 (Nov. 2011); but also Areas In Which Rulings Or Determination Letters Will Not Ordinarily Be Issued, in Rev. Proc. 2023-3, Section 4 (42) which provides:

> (42) Section 678.—Person Other than Grantor Treated as Substantial Owner.— Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Section 678(a)(1) has given rise to a different kind of planning. Suppose a beneficiary may withdraw an amount equal to all of the trust's taxable income in any given year (from all of the trust assets) but not the entire trust assets. Ed Morrow refers to this as the BDOT; IRC 678(a)(1) the "*Beneficiary Deemed Owner Trust*" (BDOT), Leimberg Estate Planning Newsletter #2516 (Sept. 5, 2017). The BDOT appears clearly effective for income shifting, but it is not quite as clear whether it makes the person with the right to withdraw the owner of the entire trust for Rev. Rul. 85-13 purposes.

The regulations governing the grantor trust rules (sections 671-679) clearly provide that the reference to "income "unless specifically limited, refers to income determined for tax purposes and not to income for trust accounting purposes. Treas. Reg. §1.671-2(b). In order for the beneficiary to be treated as the owner of the entire trust for income tax purposes under section 678(a)(1), the withdrawal power must apply to all net taxable income during the year, including capital gains. If a beneficiary may withdraw "income" then under applicable state law the concern would be that the trust means income determined for trust accounting purposes which would not typically include extraordinary dividends or capital gains.

To cause the taxable income attributable to the corpus portion of the trust also to be treated as owned by the beneficiary, the withdrawal power must apply with respect to an amount equal to all of the net taxable income. Having the corpus portion of the trust being treated as owned by the beneficiary for income tax purposes is extremely important if the beneficiary wishes to sell assets to the trust and have the transfer treated as a non-recognition event under the reasoning of Rev. Rul. 85-13. In Campbell v. Commissioner, T.C. Memo 1979-495, beneficiaries had the power to cause the trustee to distribute capital gains; beneficiaries did not request and the trustee did not distribute the capital gains income to the beneficiaries, but they were deemed to be the owners of the capital gains income under section 678(a)(1). PLR 201633021 also supports this result.

Income is taxable to a powerholder under section 678(a)(1) whether or not the amount is actually withdrawn. If it is withdrawn, such withdrawal is generally a non-taxable event because it is not a distribution that is reported under the distribution rules for non-grantor trusts. Rev. Rul. 67-241. For instance, section 678(a)(1) applies if the powerholder is a minor for whom a guardian who could exercise the power has not been appointed. Rev. Rul. 81-6 (child could withdraw all income until age 25; minority status irrelevant); Trust No. 3 v. Commissioner, 285 F.2d 102 (7th Cir. 1960)(minor beneficiaries could terminate a trust; that no guardians had been appointed was irrelevant).

What happens if the power is not exercised, as will often be the case? The trust agreement may provide that failure to withdraw the taxable income amount in a particular year would lapse and could not be exercised in a later year. If so, and if the lapsed power exceeds the greater of "(A) $5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied," the power holder will be treated as having made a gift of the excess amount (unless it is an incomplete gift because of retained powers over the trust), which will mean the property will be included in the powerholder's estate. Note that if the person with the withdrawal right is not an individual the "5 x 5 exception" may not apply; section 2514(e), which creates the exception, applies by its term to an "individual."

Generally, the net taxable income of a trust will be less than 5% of the trust value. To use the full trust value to measure the 5% amount, the beneficiary ought to be able to withdraw the net taxable income amount from all of the trust assets. In Rev. Rul. 66-87 the beneficiary had the power to withdraw accounting income and the 5% element was calculated based just on the accounting income, not all trust assets. Fish v. U.S., 432 F.2d 1278 (9th Cir. 1970), held that the 5% amount, when applied to a power to withdraw "all or part of the net income of the trust for that year" was only 5% of the income, not 5% of the trust assets. The taxpayer argued that because the income payable to the decedent would have been payable either from corpus or income, the entire trust represents "assets out of which, or the proceeds out of which, the exercise of lapsed powers could be satisfied." The court disagreed because for federal tax purposes the distribution would have been a distribution of income.

The IRS cited Fish in Rev. Rul. 85-88 to hold that where a power of appointment is limited to annual trust income the 5 percent test is based on annual trust income, not the amount of trust corpus. Neither Fish nor the Ruling considered the result if the withdrawal right could be from any trust assets. Prudence suggests that a beneficiary should be authorized to withdraw the greater of the net taxable income or 5% of the trust corpus from any of the income or out of the entire corpus of the trust. The right to withdraw may also hang.

Other issues to consider are the rights of creditors of the powerholder and the presence of a true grantor under sections 671-677 which trump section 678.

If the Fish problem can be solved, almost any trust may be taxed to a designated person, for example a person in a state without an income tax. That may not mean the trust is a wholly grantor trust with the benefits of Rev. Rul. 85-13. Does the grantor have rights over corpus? Treas. Reg. § 1.671-3(a)(1) indicates one person can own "income" but not own corpus. Put another way, what does the term "portion" mean in section 678? It could mean the "income" portion as opposed to the "corpus" portion or it could mean the undivided interest portion of the trust that a person with a right of withdrawal could withdraw, whether income or corpus. Treas. Reg. § 1.671-3 provides as follows:

> **(a)** When a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example:
>
> > **(1)** If a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner.
> >
> > **(2)** If the portion treated as owned consists of specific trust property and its income, all items directly related to that property are attributable to the portion. Items directly related to trust property not included in the portion treated as owned by the grantor or other person are governed by the provisions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Items that relate both to the portion treated as owned by the grantor and to the balance of the trust must be apportioned in a manner that is reasonable in the light of all the circumstances of each case, including the terms of the governing instrument, local law, and the practice of the trustee if it is reasonable and consistent.
> >
> > **(3)** If the portion of a trust treated as owned by a grantor or another person consists of an undivided fractional interest in the trust, or of an interest represented by a dollar amount, a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. Thus, where the portion owned consists of an interest in or a right to an amount of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus at the beginning of the taxable year in question. The share not treated as owned by the grantor or other person is governed by the provisions of subparts A through D. See the last three sentences of paragraph (c) of this section for the principles applicable if the portion treated as owned consists of an interest in part of the ordinary income in contrast to an interest in corpus alone.
>
> **(b)** If a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. For example:
>
> > **(1)** Only ordinary income is included by reason of an interest in or a power over ordinary income alone. Thus, if a grantor is treated under

section 673 as an owner by reason of a reversionary interest in ordinary income only, items of income allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another person is treated under sections 674-678 as an owner of a portion by reason of a power over ordinary income only, items of income allocable to corpus are not included in that portion. (See paragraph (c) of this section to determine the treatment of deductions and credits when only ordinary income is included in the portion.)

(2) Only income allocable to corpus is included by reason of an interest in or a power over corpus alone, if satisfaction of the interest or an exercise of the power will not result in an interest in or the exercise of a power over ordinary income which would itself cause that income to be included. For example, if a grantor has a reversionary interest in a trust which is not such as to require that he be treated as an owner under section 673, he may nevertheless be treated as an owner under section 677(a)(2) since any income allocable to corpus is accumulated for future distribution to him, but items of income included in determining ordinary income are not included in the portion he is treated as owning. Similarly, he may have a power over corpus which is such that he is treated as an owner under section 674 or 676 (a), but ordinary income will not be included in the portion he owns, if his power can only affect income received after a period of time such that he would not be treated as an owner of the income if the power were a reversionary interest. (See paragraph (c) of this section to determine the treatment of deductions and credits when only income allocated to corpus is included in the portion.)

(3) Both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within the provisions of subparagraph (2) of this paragraph. For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in the portion. Further, a grantor includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated under section 674 or 676 as an owner because of a power over corpus which can affect income received within a period such that he would be treated as an owner under section 673 if the power were a reversionary interest. Similarly, a grantor or another person includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated as an owner under section 675 or 678 because of a power over corpus.

(c) If only income allocable to corpus is included in computing a grantor's tax liability, he will take into account in that computation only those items of income, deductions, and credit which would not be included under subparts A through D in the computation of the tax liability of the current income beneficiaries if all distributable net income had actually been distributed to those beneficiaries. On the other hand, if the grantor or another person is treated as an owner solely because of his interest in or power over ordinary income alone, he will take into account in computing his tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to corpus which enter into the computation of distributable net income. If the grantor or other person is treated as an owner because of his power over or right to a dollar amount of ordinary income, he will first take into account a

> portion of those items of income and expense entering into the computation of ordinary income under the trust instrument or local law sufficient to produce income of the dollar amount required. There will then be attributable to him a pro rata portion of other items entering into the computation of distributable net income under subparts A through D, such as expenses allocable to corpus, and a pro rata portion of credits of the trust. For examples of computations under this paragraph, see paragraph (g) of § 1.677(a)-1.

If one trust can withdraw all of the assets of the other trust, the trust with the withdrawal right seems clearly the owner of the whole trust for income tax purposes. But with a more limited withdrawal right the result is uncertain. An example of a power to vest "the income therefrom" is described in Private Letter Ruling 201633021. The ruling involved Trust 1 and Trust 2 which were non-grantor trusts because the grantor had died. The assets of Trust 1 and Trust 2 are held for the benefit of the same beneficiaries. The governing document of Trust 2 provides that Trust 1 retains the power, solely exercisable by Trust 1, to revest the net income of Trust 2 in Trust 1; provided, however, that such power shall lapse on the last day of such calendar year. Trust 2 further provides that income includes (i) any dividends, interest, fees and other amounts characterized as income under section 643(b) of the Code, (ii) any net capital gains realized with respect to assets held less than twelve months, and (iii) any net capital gains realized with respect to assets held longer than twelve months. The ruling provides that the trustee "proposes to transfer funds from Trust 1 to Trust 2."

The IRS concluded:

> Trust 1 will be treated as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a). Accordingly, Trust 1 will take into account in computing their tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to which enter into the computation of distributable net income. Additionally, Trust 1 will also take into account the net capital gains of Trust 2." The ruling unfortunately does not provide any insight on what the income tax consequences would be when Trust 1 "transfers funds" to Trust 2. The language of the ruling implies the Trust 1 will be treated as a beneficiary of Trust 2 but also "as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a).

The language doesn't necessarily (but it could) mean that Trust 1 is the deemed owner entirely of Trust 2 and all of its assets. If Trust 1 is treated as the owner entirely of Trust 2, then theoretically Trust 1 could engage in a sale of the assets of Trust 1 to Trust 2 in exchange for an installment note, and the transaction would be disregarded for income tax purposes under Revenue Ruling 85-13. This would be the result if Trust one could withdraw all the assets of Trust 2 at any time.

If, however, Trust 1 is merely an entity that must report the income, capital gain, expenses, and other items used to compute DNI, then such a transaction could, in part, be considered a taxable event. Even if the latter interpretation is correct, if Trust 1 is a non-GST exempt trust and Trust 2 is a GST exempt trust, the tax liability borne by Trust 1 from all of Trust 2's income and capital gain could significantly increase Trust 2's trust assets over time and decrease the assets in Trust 1.

In PLR 202022002, the trust agreement of a Trust 1 prohibited the distribution of Shares (perhaps of a closely-held company) to the beneficiaries, but allowed for the distribution of the proceeds from the sale of Shares. Trust 1 contributed all of its Shares to LLC, a newly formed entity classified as partnership for Federal tax purposes, in exchange for membership interest in LLC. The same restrictions on the Shares were placed on the membership interests of LLC. Trust 1 then transferred a portion of its LLC interest to a Subtrust for the sole benefit of A. After A reached the age of 40, A exercised a withdrawal right to take all of the Subtrust's assets, except the LLC interests. The Subtrust agreed to sell a portion of its LLC interests to Trust 2 in exchange for cash and a promissory note. Trust 2 is a grantor trust with respect to A. A also had the authority to withdraw the cash and promissory note from Subtrust after the sale. The IRS concluded, "because A has a power exercisable by herself to vest the proceeds of Subtrust's LLC interest in herself and that those proceeds are Subtrust's only asset, A will be treated as the owner of Subtrust under § 678. Consequently, the transfer of the LLC interests to Trust 2 is not recognized as a sale for federal income tax purposes because Trust 2 and Subtrust are both wholly owned by A."

When doing trust to trust transactions, if the trusts are not grantor trusts, it would be best to have one trust have a withdrawal right over all assets of the other trust.

2. **Gain Recognition When Trust Terminates By The Beneficiaries**. In PLR 202509010, the beneficiaries of a GST grandfathered trust agreed to terminate the trust with the parties receiving the actuarial value of their interests The trust was described as follows:

> On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust, for the benefit of Grandchild. Under the terms of Trust, the co-trustees are required to pay to Grandchild an annual annuity of $x. No other distributions are permitted during Grandchild's lifetime. Upon Grandchild's death, the $x annuity shall be divided and paid *per stirpes* to Grandchild's lineal issue. Grandchild has two living adult children, A and B (Current Remaindermen) and four living minor grandchildren, C, D, E, and F (Successor Remaindermen). None of Grandchild's lineal issue has a predeceased child with living issue. Trust shall terminate upon the last to die of ten individuals, including Grandchild. Upon termination of Trust, all trust property is required to be distributed *per stirpes* to the lineal issue of Grandchild, outright and free of Trust. The Current Remaindermen and the Corporate Trustee are currently serving as co-trustees of Trust.

The IRS determined that the termination would not affect the GST grandfathered status of the trust nor be a gift by any beneficiary. The GST ruling is based on the actuarial values being accurate; the ruling notes that an unnamed valuation company will make that determination. The calculation could be complicated, and risky.

The ruling also determines that the transaction is in substance a sale:

> Although the proposed transaction takes the form of a distribution of Trust's property in accordance with the actuarial value of the respective interests of Grandchild, the Current Remaindermen, and the Successor Remaindermen, in substance it is a sale of Grandchild's and the Successor Remaindermen's interests to the Current Remaindermen, and an exchange by the Current Remaindermen of their interests with the other beneficiaries. *Frank Lyon Co. v. U.S.*, 435 U.S. 561,

582 (1978) (substance and economic realities of sale-lease transaction supported taxpayer's deductions for depreciation, interest and related expenses). Accordingly, the amounts received by Grandchild as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Rev. Rul. 72-243. Because Grandchild's basis in the income interest of Trust is a portion of the entire basis of the property under § 1015(b), and because the disposition of her term interest is not part of a transaction in which the entire interest in Trust is transferred to a third party, her adjusted basis in her interest in Trust is disregarded under § 1001(e). Grandchild's holding period in the life interest in Trust exceeds one year. Accordingly, based on the facts submitted and the representations made, the entire amount realized by Grandchild as a result of the early termination of Trust will be long-term capital gain under § 1222(3).

Similarly, the amounts received as the Proposed Distribution by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen *Cf. Helvering v. Gambrill*, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364 (The phrase ""property held by the taxpayer" under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The amounts realized will be the fair market value of the Proposed Distribution received by the Successor Remaindermen. Their holding periods in their interests in Trust also exceed one year. Accordingly, under § 1222(3), the gain determined under § 1001(a) for the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.

In addition, to the extent that the Current Remaindermen exchange property, including property deemed received from Trust, for the interests of Grandchild and the Successor Remaindermen, the Current Remaindermen will recognize gain or loss on the property exchanged. § 1.1001-1(a). Accordingly, based on the facts submitted and the representations made, for purposes of determining gain or loss in connection with the Proposed Distribution, the amount realized by the Current Remaindermen on the exchange of property for Trust interests held by Grandchild and the Successor Remaindermen will be equal to the fair market value of the Proposed Distribution made to Grandchild and to the Successor Remaindermen. *See* § 1.1001-1(a).

E. SECTION 1361 – S CORPORATIONS

F. SECTIONS 2031 and 2512 – VALUATION

1. Validity of Buy-Sell Agreement and Effect of Life Insurance Paid to Company On The Value. Connelly v. United States, 2021 WL 4281288 (E.D. Mo. 2021), dealt with the valuation of Crown C Supply, Inc. in the estate of Michael Connelly. The parties stipulated the value was $3.1 million excluding $3.5 million of life insurance paid to the company at Michael's death, and ignoring a buy-sell agreement. The court first concluded that the buy-sell agreement did not satisfy the requirements of section 2703. The opinion states:

The parties here have stipulated that the Connelly brothers entered the Stock Agreement for the purpose of ensuring continued family ownership over Crown C. Doc. 47 at ¶¶ 1-3. The IRS does not provide any support for its contention that the Estate's actions taken after Michael's death alter the purpose of the Stock Agreement, making it no longer a bona fide business arrangement. Doc. 61 at p.

12. Based on the parties' stipulation, the Court deems the Stock Agreement a bona fide business arrangement for purposes of summary judgment.

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For a buy-sell agreement to control the value of property for estate-tax purposes, it must not be a substitute for a testamentary disposition, ensuring that transactions between family members reflect full-and-adequate consideration. *See* 26 C.F.R. § 25.2703-1(b)(4) (price must be comparable to what an unrelated third party would pay, taking into account fair market value); *Estate of Lauder*, 1992 WL 386276, *21 (plaintiff must demonstrate full-and-adequate consideration in money or money's worth). The existence of a bona fide business purpose does not exclude the possibility that a buy-sell agreement is a testamentary device. 26 C.F.R. § 25.2703-1(b)(2); *see also St. Louis County Bank*, 674 F.2d at 1210. Further, "intrafamily agreements restricting the transfer of stock in a closely held corporation must be subjected to greater scrutiny than that afforded similar agreements between unrelated parties." *Estate of Lauder*, 1992 WL 386276, *20 (citing *Dorn v. United States*, 828 F.2d 177, 182 (3d Cir. 1987)); *see also Hoffman v. Comm r*, 2 T.C. 1160, 1178-1179 (T.C. 1943), *affd. sub nom. Giannini v. Comm'r*, 148 F.2d 285 (9th Cir. 1945) ("[T]he fact that the option is given to one who is the natural object of the bounty of the [decedent] requires substantial proof to show that it rested upon full-and-adequate consideration.").

Despite the legitimate business purpose of the Stock Agreement, the Estate bears the burden of proving that the Stock Agreement was not also a device to pass Crown C shares to members of the Connelly family for less than full-and-adequate consideration. *See Estate of Lauder*, 1992 WL 386276, *21. The Estate asserts that the Stock Agreement was not a testamentary device because (1) Crown C redeemed Michael's shares for fair market value, as established by the parties' stipulation to the value of Michael's shares, (2) the Stock Agreement was binding, because Crown C redeemed Michael's shares, and (3) the Connelly brothers were in good health when they executed the Stock Agreement. Doc. 65 at p. 7.

The Estate failed to show that the Stock Agreement was not a device to transfer wealth to Michael's family members for less than full-and-adequate consideration. First, the $3 million redemption price was not full-and-adequate consideration. The parties' stipulation explicitly left aside the life-insurance issue when it otherwise agreed to the $3.1 million fair market value of Michael's Crown C shares. Doc. 48. Therefore, the stipulation only aids the Estate if the Court finds that the fair market value excludes the $3 million in life-insurance proceeds used to redeem Michael's shares. In other words, the $3 million redemption price is only equivalent to the fair market value of the shares *if* the Court were to find that the $3 million in life-insurance proceeds are not included in Crown C's value. As discussed in section III.B.1 below, the Court follows the reasoning from the Tax Court in *Estate of Blount*, so the life-insurance proceeds are included in Crown C's fair market value. *Estate of Blount v. Comm'r*, 2004 WL 1059517, at *26 (T.C. 2004), a*ff'd in part, rev'd in part on other grounds*, 428 F.3d 1338 (11th Cir. 2005).

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Additionally, the Stock Agreement's lack of a minority discount for Thomas's shares and corresponding lack of a control premium for Michael's shares substantially overvalues Thomas's shares and undervalues Michael's shares. The Stock Agreement required that in determining the appraised value of the shareholders' shares in Crown C, "[t]he appraisers shall not take into consideration premiums or minority discounts[.]" Doc. 53-4, Art. VII., Sec. C. The Stock Agreement's lack of a control premium for Michael's majority interest indicates that the price was not full-and-adequate consideration. *See* 26 C.F.R. § 20.2031-2(f)(2) (fair market value for a corporation's stock is determined by "the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors" including "the degree of control of the business represented by the block of stock to be valued . . ."); *Bright's Estate v. U.S.*, 658 F.2d 999, 1006-7 (5th Cir. 1981) (a willing buyer would account for a controlling interest or a minority interest in a closely-held corporation); *Estate of True v. Comm'r*, 2001 WL 761280, at *100 (T.C. 2001) ("[Plaintiff's] 58.16-percent interest represented a majority of the shares entitled to vote; therefore, [Plaintiff] owned a controlling interest in Black Hills Trucking at his death. Accordingly, [the expert] should have added a control premium to compute entity value . . ."); *see also Zaiger's Estate v. Comm'r*, 64 T.C. 927, 945-46 (T.C. 1975) ("Petitioner's experts applied discounts to their valuations to reflect the minority interest involved and to compensate for the fact that voting control would not be in the hands of the purchaser. Such considerations were proper and discounts were appropriate.").

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The Estate does not show that the Stock Agreement is comparable to similar agreements negotiated at arms' length. Courts treat a contractual restriction as comparable to similar agreements if it "could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm's length." 26 C.F.R. § 25.2703-1(b)(4) (this determination considers factors such as "the expected term of the agreement, the current fair market value of the property, anticipated changes in value during the term of the arrangement, and the adequacy of any consideration given in exchange for the rights granted."). The question is whether, "[a]t the time the right or restriction is created, the terms of the right or restriction are comparable to similar arrangements entered into by persons in an arm's length transaction." 26 C.F.R. § 25.2703-1(b)(1)(iii); *Holman v. Comm r*, 130 T.C. 170, 197 (T.C. 2008), *affd*, 601 F.3d 763 (8th Cir. 2010) ("Comparability is determined at the time the restriction is created.").

In *Blount*, the Tax Court held that to show comparability, the estate had to produce evidence "that the terms of an agreement providing for the acquisition or sale of property for less than fair market value are similar to those found in similar agreements entered into by unrelated parties at arm's length in similar businesses." *Estate of Blount*, 2004 WL 1059517, at *17 (T.C. 2004), *aff'd in part, rev'd in part on other grounds*, 428 F.3d 1338 (11th Cir. 2005); *see also Holman*, 130 T.C. at 198-99. The Tax Court relied on the text of 26 U.S.C. § 2703(b)(3), legislative history, and the text of the applicable regulations, 26 C.F.R. § 25.2703-1(b)(4).

The Court agrees with this analysis. The statutory text of 26 U.S.C. § 2703(b)(3) uses terms that require a comparison of the agreement at issue to others ("comparable to similar arrangements") and that those other agreements must be the product of "arm's length transaction(s)." In the face of this plain text, legislative history need not be consulted, but even so, the Senate committee report supports this textual analysis. *See* 136 Cong. Rec. 15683 (Oct. 18, 1990) (discussing consideration of various factors, including "the demonstration of general practice(s) of unrelated parties, " and expert testimony). The regulations also track the "general practice(s) of unrelated parties" language of the Senate committee report, and further require the showing of comparables from similar businesses. 26 C.F.R. 25.2703-(1)(b)(4).

A related problem for the estate was that the parties didn't actually follow the process in the buy-sell agreement for setting value. The parties could have agreed annually or, if not, engaged appraisers after death, but did neither as discussed by the court:

> The Stock Agreement required shareholders Michael and Thomas to agree on and sign "Certificates of Agreed Value" every year to establish the price-per-share; but in the 12 years the agreement was in place before Michael's death, they never agreed on the value, or created or signed such certificates. Doc. 61 at p. 5; Doc. 53-4, Art. VII., Sec. A-B. Under the Stock Agreement, the failure of the shareholders to do so triggered the obligation to obtain the Appraised Value Per Share through a very specific process involving multiple professional appraisers. Doc. 53-4, Art. VII., Sec. C. But Thomas and the Estate never followed that specific process and never determined the Appraised Value Per Share; instead, they chose to come up with their own *ad hoc* valuation of $3 million. Doc. 58 at ¶¶ 23-38; Doc. 51 at p. 4.
>
> The Court finds that Crown C's share price was not "fixed and determinable" from the 2001 Stock Agreement. *See Estate of Lauder*, 1992 WL 386276, *18 ("Several requirements have evolved for testing whether the *formula price set forth in such restrictive agreements* is binding for purposes of the Federal estate tax. It is axiomatic that *the offering price* must be fixed and determinable under the agreement." (emphasis added)); *see also* 26 C.F.R. § 20.2031 2(h) ("The effect, if any, that is given to the option or contract price in determining the value of the securities for estate-tax purposes depends upon the circumstances of the particular case.").
>
> The $3 million redemption price that Thomas and the Estate set forth in the Sale Agreement did not come from any formula or other provisions in the Stock Agreement, rendering the Estate's proposed share price, for estate-tax-valuation purposes, neither fixed nor determinable from the Stock Agreement. Doc. 58 at ¶¶ 23-38. The parties did not rely on a Certificate of Agreed Value or follow the detailed appraisal mechanism of the Stock Agreement to determine the price-per-share; instead, they completely disregarded the Stock Agreement and negotiated their own value, which not surprisingly was less than the value of the life-insurance proceeds. *Id.* at ¶¶ 23-38, 64-65; *see also* 26 C.F.R. § 20.2031-2(h).

Because the brothers didn't sign a certificate during life or follow the valuation procedure after death, the court concluded the agreement wasn't binding on the parties as required by section 2703.

Next the court turned to the valuation of the company given the life insurance and redemption obligation. The court agreed with the Tax Court in <u>Blount</u> but specifically rejected the Eleventh Circuit's reversal in that case as being "demonstrably erroneous." The opinion states:

> The parties agree that the facts of this case present the same fair-market-value issue as *Estate of Blount*, 2004 WL 1059517, at *26 (T.C. 2004), a*ff'd in part, rev'd in part*, 428 F.3d 1338 (11th Cir. 2005). Doc. 52 at 12; Doc. 46 at 6-7. In *Estate of Blount*, a closely-held family company entered into a stock purchase agreement with its shareholders, intending that the company would use life-insurance proceeds to redeem a key shareholder's shares upon his death. 428 F.3d at 1340. When one of the shareholders died, his estate argued that the life-insurance proceeds should not be included in the value of the company, for purposes of determining fair market value of the redeemed shares, because of the

company's offsetting contractual obligation to redeem those shares from the estate. *Id.* at 1345.

The Tax Court in *Estate of Blount* included the life-insurance proceeds in the value of the company and the shareholders' shares, determining that the redemption obligation was not like an ordinary liability because the redemption involved the very same shares being valued. 2004 WL 1059517, at *26. The Eleventh Circuit reversed on this issue, holding that the fair market value of the closely-held corporation did not include life-insurance proceeds used to redeem the shares of the deceased shareholder under a stock purchase agreement. *Estate of Blount*, 428 F.3d at 1346. The Eleventh Circuit reasoned that the stock-purchase agreement created a contractual liability for the company, offsetting the life-insurance proceeds. *Id.* at 1345-46. The Eleventh Circuit concluded that the insurance proceeds were "not the kind of ordinary nonoperating asset that should be included in the value of [the company] under the treasury regulations" because they were "offset dollar-for-dollar by [the company's] obligation to satisfy its contract with the decedent's estate." *Id.* at 1346 (citing 26 C.F.R. § 20.2031-2(f)(2)).

The IRS urges the Court to reject the Eleventh Circuit's holding in *Estate of Blount* and apply the Tax Court's reasoning. Doc. 52 at 12-14. The IRS contends that the Eleventh Circuit's approach violates customary valuation principles, resulting in a below-market valuation for Crown C and a windfall for Thomas at the expense of Michael's estate. *Id.* According to the IRS, a willing buyer and seller would value Crown C at approximately $6.86 million, rather than $3.86 million, because on the date of Michael's death, Crown C possessed the $3 million in life insurance proceeds that were later used to redeem Michael's shares. *Id.* at 19. This, in turn, would make Michael's 77.18% interest in Crown C worth about $5.3 million. *Id.* The Estate disagrees, somewhat reflexively arguing that under the Eleventh Circuit's holding in *Estate of Blount*, the Court should not include the $3 million in life-insurance proceeds in the valuation of Crown C because of the redemption obligation in the Stock Agreement. Doc. 46 at p. 6. But other than citing the Eleventh Circuit's holding and its own expert opinions (which essentially say that holding controls), the Estate does not really explain *why* it believes the Eleventh Circuit's holding is correct. *Id.*

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Consider what a hypothetical "willing buyer" would pay for a company subject to a redemption obligation. *See* 26 C.F.R. § 20.2031-1(b). The willing buyer would not factor the company's redemption obligation into the value of the company, because with the purchase of the entire company, the buyer would thereby acquire all of the shares that would be redeemed under the redemption obligation; in other words the buyer would pay all of the shareholders the fair market value for all of their shares. The company, under the buyer's new ownership, would then be obligated to redeem shares *that the buyer now holds*. Since the buyer would receive the payment from the stock redemption, the buyer would not consider the obligation *to himself* as a liability that lowers the value of the company *to him*. *See Estate of Blount*, 2004 WL 1059517, at *25 (T.C. 2004) ("To treat the corporation's obligation to redeem the very shares that are being valued as a liability that reduces the value of the corporate entity thus distorts the nature of the ownership interest represented by those shares.").

A willing buyer purchasing Crown C on the date of Michael's death would not demand a reduced purchase price because of the redemption obligation in the Stock Agreement, as Crown C's fair market value would remain the same regardless. The willing buyer would buy all 500 of Crown C's outstanding shares (from Michael's Estate and Thomas) for $6.86 million, acquiring Crown C's $3.86 million in estimated value plus the $3 million in life-insurance proceeds at issue. If Crown C had no redemption obligation, the willing buyer would then own 100% of a company worth $6.86 million.

But even with a redemption obligation, Crown C's fair market value remains the same. Once the buyer owned Crown C outright, the buyer could either: 1) cancel the redemption obligation to himself and own 100% of a company worth $6.86 million, or 2) let Crown C redeem Michael's former shares-the buyer (and not Michael's Estate) would receive roughly $5.3 million in cash and then own 100% of a company worth the remaining value of about $1.56 million, leaving the buyer with a total of $6.86 million in assets. Therefore, with or without the redemption obligation, the fair market value of Crown C on the date of Michael's death was $6.86 million.

The Estate urges the Court to follow the Eleventh Circuit's reasoning in *Estate of Blount*, which declared that "nonoperating assets should not be included in the fair market valuation of a company where, as here, there is an enforceable contractual obligation that offsets such assets." 428 F.3d at 1346 (quotation marks omitted). But as the IRS points out, the Court must determine the fair market value of Crown C on the date of Michael's death, not the value in its postredemption configuration. *See* 26 U.S.C. § 2031. Excluding the insurance proceeds from Crown C's value impermissibly treats Michael's shares as both outstanding and redeemed at the same time, reducing Crown C's value by the redemption price of the very shares whose value is at issue. This approach ignores the ownership interest represented by Michael's shares; construing a redemption obligation as a corporate liability only values Crown C post redemption (i.e., excluding Michael's shares), not the value of Crown C on the date of death (i.e. including Michael's shares).

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The Court finds the Tax Court's reasoning in *Estate of Blount* persuasive. *Estate of Blount*, 2004 WL 1059517, at *24-27; *see also* Adam S. Chodorow, *Valuing Corporations for Estate Tax Purposes: A Blount Reappraisal*, 3 Hastings Business Law Journal 1, 25 (2006) ("Taking redemption obligations into account leads the court to value the wrong property . . . redemption obligations are different from other types of corporate obligations in that a redemption obligation both shrinks the corporate assets and changes its ownership structure."). A redemption obligation is not an ordinary corporate liability--a stock redemption involves a change in the ownership structure of the company, where the company buys a shareholder's interest--so a redemption obligation does not change the value of the company as a whole *before the shares are redeemed*. Nor can a redemption obligation diminish the value of the same shares being redeemed; the shareholder is essentially "cashing out" his share of ownership in the company and its assets. Moreover, a stock redemption results in the company (and more specifically its remaining shareholder(s)) getting something of equal value for the cash spent, i.e. the decedent's share of ownership in the company; the exchange increases the ownership interest for each of the company's outstanding shares, i.e. the surviving shareholders' shares.

For these reasons, the Court respectfully finds that the Eleventh Circuit's opinion in *Estate of Blount* is "demonstrably erroneous" and there are "cogent reasons for rejecting [it]." *Keasler v. United States*, 766 F.2d 1227, 1233 (8th Cir. 1985) ("[T]he tax decisions of other circuits should be followed unless they are

> demonstrably erroneous or there appear cogent reasons for rejecting them." (internal quotation marks and citation omitted)). Accordingly, the Court holds that the $3 million in life-insurance proceeds used to redeem Michael's shares must be included in the fair market value of Crown C and of Michael's shares.

Connelly was appealed to the Eighth Circuit which affirmed the District Court on both issues. Connelly v. United States, 2023 WL 3769233 (8th Cir. 2023).

The Supreme Court granted certiorari, 144 S.Ct. 536 (2023), and oral argument was held on March 27, 2024. Unsurprisingly, the Supreme Court affirmed - Connelly v. United States, ________ (S.Ct. 2024) - on June 6, 2024, in a unanimous opinion by Justice Thomas. The Court concluded that a redemption obligation is not an ordinary debt:

> Thomas argues that a contractual obligation to redeem shares is a liability that offsets the value of life-insurance proceeds used to fulfill that obligation. Brief for Petitioner 17. He accordingly contends that anyone purchasing "a subset of the corporation's shares would treat the two as canceling each other out." *Ibid.* By contrast, the Government argues that Crown's obligation to pay for Michael's shares did not reduce the value of those shares. It contends that "no real-world buyer or seller would have viewed the redemption obligation as an offsetting liability." Brief for United States 15. We agree with the Government.
>
> An obligation to redeem shares at fair market value does not offset the value of life-insurance proceeds set aside for the redemption because a share redemption at fair market value does not affect any shareholder's economic interest. A simple example proves the point. Consider a corporation with one asset—$10 million in cash—and two shareholders, A and B, who own 80 and 20 shares respectively. Each individual share is worth $100,000 ($10 million ÷ 100 shares). So, A's shares are worth $8 million (80 shares x $100,000)and B's shares are worth $2 million (20 shares x $100,000). To redeem B's shares at fair market value, the corporation would thus have to pay B $2 million. After the redemption, A would be the sole shareholder in a corporation worth $8million and with 80 outstanding shares. A's shares would still be worth $100,000 each ($8 million ÷ 80 shares). Economically, the redemption would have no impact on either shareholder. The value of the shareholders' interests after the redemption—A's 80 shares and B's $2 million in cash—would be equal to the value of their respective interests in the corporation before the redemption. Thus, a corporation's contractual obligation to redeem shares at fair market value does not reduce the value of those shares in and of itself.
>
> Because a fair-market-value redemption has no effect on any shareholder's economic interest, no willing buyer purchasing Michael's shares would have treated Crown's obligation to redeem Michael's shares at fair market value as a factor that reduced the value of those shares. At the time of Michael's death, Crown was worth $6.86 million—$3 million in life-insurance proceeds earmarked for the redemption plus $3.86 million in other assets and income-generating potential. Anyone purchasing Michael's shares would acquire a 77.18% stake in a company worth $6.86 million, along with Crown's obligation to redeem those shares at fair market value. A buyer would therefore pay up to $5.3 million for Michael's shares ($6.86 million x 0.7718)—*i.e.*, the value the buyer could expect to receive in exchange for Michael's shares when Crown redeemed them at fair market value. We thus conclude that Crown's promise to redeem Michael's shares at fair market value did not reduce the value of those shares.

Justice Thomas seems not to have had a lesson in valuation discounts but is better versed in various buy-sell arrangements:

> Finally, Thomas asserts that affirming the decision below will make succession planning more difficult for closely held corporations. He reasons that if life-insurance proceeds earmarked for a share redemption are a net asset for estate-tax purposes, then "Crown would have needed an insurance policy worth far more than $3 million in order to redeem Michael's shares at fair market value." Brief for Petitioner 33. True enough, but that is simply a consequence of how the Connelly brothers chose to structure their agreement. There were other options. For example, the brothers could have used a cross-purchase agreement—an arrangement in which shareholders agree to purchase each other's shares at death and purchase life-insurance policies on each other to fund the agreement. See S. Pratt, Valuing a Business821 (6th ed. 2022). A cross-purchase agreement would have allowed Thomas to purchase Michael's shares and keep Crown in the family, while avoiding the risk that the insurance proceeds would increase the value of Michael's shares. The proceeds would have gone directly to Thomas—not to Crown. But, every arrangement has its own drawbacks. A cross-purchase agreement would have required each brother to pay the premiums for the insurance policy on the other brother, creating a risk that one of them would be unable to do so. And, it would have had its own tax consequences. By opting to have Crown purchase the life-insurance policies and pay the premiums, the Connelly brothers guaranteed that the policies would remain in force and that the insurance proceeds would be available to fund the redemption. As we have explained, however, this arrangement also meant that Crown would receive the proceeds and thereby increase the value of Michael's shares. Thomas' concerns about the implications of how he and Michael structured their agreement are therefore misplaced.

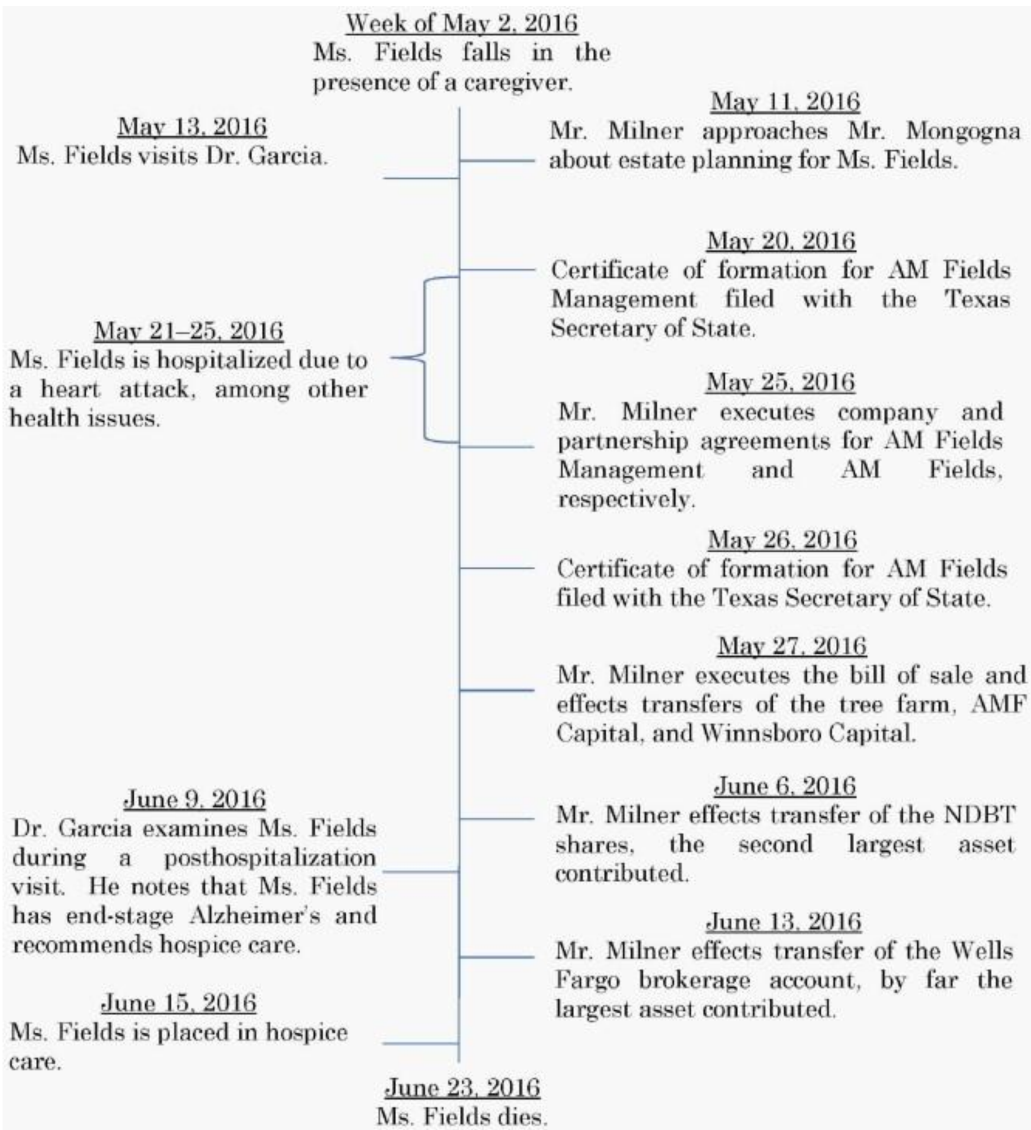
G. SECTION 2032 — ALTERNATE VALUATION AND SECTION 2032A — SPECIAL USE VALUATION

1. New Proposed Alternate Valuation Regulations. [WAITING ON FINAL REGULATIONS.] An estate may elect alternate valuation and value its assets as of six months after death for estate tax purposes. If the alternate valuation date is elected, property disposed of before six months after death is valued on the date of the disposition. §2032 was originally enacted in 1935, after the stock market crash of 1929. On April 25, 2008, Treasury issued proposed Regulations to restrict the application of section 2032 by preventing post-death events other than market conditions from being taken into account when valuing the property. REG-112196-07. Those Proposed Regulations defined market conditions as events outside the control of the decedent, the decedent's executor or trustee, or any other person whose property being valued affected the fair market value of the property. The government's defeat in Kohler v. Commissioner, T.C. Memo. 2006-152, inspired the Proposed Regulations. The Tax Court ruled in Kohler that stock received by an estate in a post-death reorganization should be the property valued on the alternate valuation date and that the restrictions placed on the stock should be taken into account. In its action on decision stating non-acquiescence, the IRS took the view that the court incorrectly applied the regulations by allowing a post-death change in the character of the property to be taken into account when determining the property's value. The IRS thought that the court misapplied Treas. Reg. § 20.2032-1(c)(1), which provides that a tax-free reorganization is not a disposition under section 2032.

H. SECTION 2033 – GROSS ESTATE

I. SECTIONS 2035-2038 – RETAINED INTERESTS

1. **Death-Bed Limited Partnership Disregarded Under Section 2036**. Estate of Fields, T.C. Memo. 2024-90, is a blast from the past. The decedent was diagnosed with Alzheimer's in 2011. Her affairs were managed by a great-nephew (her husband had died in 1963 and she had no children) via a power of attorney. As the decedent's health worsened and she began to fall despite regular care, in the spring of 2016 – when she was 91 years old – a limited partnership was created, with an LLC controlled by the great-nephew as general partner. The opinion sets forth this timeline:



Although the decedent had experienced some financial elder abuse, and the strategy made asset management easier, the court found there were no real non-tax reasons for the partnership. In making that finding, the court noted the following factors:

> 1. There is no evidence of any discussion of transferring Ms. Fields's assets into partnership form (other than those already in AMF Capital and Winnsboro Capital) until Ms. Fields's health appeared to be in precipitous decline. Yet thereafter the transfers proceeded rapidly.
>
> 2. Leading up to the formation of AM Fields, there were no significant changes in the amount or composition of Ms. Fields's wealth that might reasonably have triggered a nontax concern for asset management that did not exist before.
>
> 3. The instances of financial elder abuse had occurred years before the formation of AM Fields.
>
> 4. The record contains no contemporaneous documentary evidence of Mr. Milner's motivations for effecting the AM Fields transactions other than the email from Mr. Katzen to David Katzen about "obtaining a deeper discount" of Ms. Fields's partnership interest for tax purposes.
>
> 5. The assets transferred to AM Fields were of a disparate character, promised no obvious synergies with each other, and came almost exclusively from Ms. Fields. Therefore, there was virtually no prospect of "intangibles stemming from a pooling [of assets] for joint enterprise." *See Estate of Harper v. Commissioner*, T.C. Memo. 2002-121, 83 T.C.M. (CCH) 1641, 1654.
>
> 6. The assets transferred to AM Fields were not "working" interests in any business requiring active management. *Cf. Kimbell*, 371 F.3d at 267.
>
> 7. Ms. Fields was not herself involved in any of the partnership planning or management. Rather, Mr. Milner represented both her interests and his own.
>
> 8. The asset transfers depleted Ms. Fields's liquidity to the point that the Estate could not pay Ms. Fields's bequests or its reported estate tax liability.

As the court notes, the limited partnership owned most of the decedent's assets and immediately after her death distributions to the estate were made, first to pay charitable bequests, and then to pay federal estate tax. The court applied section 2036(a) to pull the assets in, and applied section 2040 as well but without double inclusion:

> Since the transfer of Ms. Fields's assets to AM Fields was not a bona fide sale, and since she retained applicable rights and interests with respect to those assets up until her death, section 2036(a) includes in the gross estate the date-of-death fair market value of the transferred assets. However, we must still address the interaction of section 2036(a) with sections 2033 and 2043. Section 2033 provides that "[t]he value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of [her] death." Section 2043(a) provides that if a transfer described in section 2036 is made
>
>> for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there

> shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

> The interaction of sections 2033, 2036, and 2043 is best explained by the formula set out in *Estate of Moore*, T.C. Memo. 2020-40, at *42, as follows:
>
>> The number that needs to be included in the gross estate [on account of sections 2033, 2036, and 2043] can be expressed in an equation: $V_{included} = C_d + FMV_d - C_t$, where
>>
>> $V_{included}$ = value that must be added to the gross estate;
>>
>> C_d = date-of-death value of the consideration received by the decedent from the transaction that remains in [her] estate, *see* [I.R.C. §] 2033;
>>
>> FMV_d = fair market value at date of death of property transferred by the decedent whose value is included in the gross estate under section 2036; and
>>
>> C_t = consideration received by the decedent at the time of the transfer, which has to be subtracted under section 2043(a).
>
> (Footnote omitted.) *See also Estate of Powell*, 148 T.C. at 414–15. Here, C_d is the value of Ms. Fields's interest in AM Fields on the date of her death (June 23, 2016), FMV_d is the death-of-death value of the five of Ms. Fields's assets contributed to AM Fields, and C_t is the value of Ms. Fields's interest in AM Fields on May 27, 2016. C_d and C_t are only 27 days apart, and neither party has argued that Ms. Fields's partnership interest changed in value over that short time. Therefore, those two partnership valuation numbers cancel out (i.e., $C_d - C_t = 0$), and we are left with determining the fair market value of the assets transferred (i.e., $V_{included} = FMV_d$). The net inclusion under sections 2036(a), 2043(a), and 2033 is effectively the date-of-death fair market value of the five transferred assets.

Planning with older decedents is often difficult. Suppose the client transfers assets to an irrevocable trust taxed to the client as grantor, over which the client retains lifetime and testamentary general powers of appointment. A child or other individual, as in Fields, is trustee. The client is not a beneficiary of the trust and there are no other beneficiaries during the client's lifetime. The trustee funds an LLC with the trust assets, and sells the non-voting LLC interests to family members or another trust for fair market value. That may be arranged as a taxable sale, or not, for income tax purposes. Arguably, the decedent has no involvement in the formation of the LLC that would implicate section 2036. At the client's death, the trust assets would be the non-voting LLC interests, included in the client's estate because of the power of appointment.

J. **SECTIONS 2041 AND 2514 — GENERAL POWERS OF APPOINTMENT**

K. **SECTIONS 61, 83, 409A, 2042 AND 7872 - LIFE INSURANCE**

L. **SECTION 2053 and 2054 - DEBTS AND ADMINISTRATION EXPENSES**

1. Guidance Under Section 2053 Regarding Deduction for Interest Expense and Amounts Paid Under a Personal Guarantee, Certain Substantiation Requirements, and Applicability of Present Value Concepts. The IRS has issued proposed regulations under section 2053, which are a follow-on to Final Regulations issued on October 20, 2009. REG-130975-08 (published June 28, 2022). Prior to the change in administrations, we had a "read the tea leaves" guess that final regulations were coming along soon. What the tea leaves say now is less certain.

The proposed regulations address four areas: (1) guidance on the proper use of present-value principles in determining the amount deductible by an estate for funeral expenses, administration expenses, and certain claims against the estate; (2) guidance on the deductibility of interest expense accruing on tax and penalties owed by an estate, and interest expense accruing on certain loan obligations incurred by an estate; (3) the requirements for substantiating the value of a claim against an estate that is deductible; and (4) guidance on the deductibility of amounts paid under a decedent's personal guarantee. Mortgage claims deductible under §20.2053-7 are not subject to the present value rule.

With respect to the present value issue, the proposed regulations create a three year grace period; before that, there is no reduction to present value, but after that, reduction back to the date of death. The proposed regulations provide:

> §20.2053-1(d)(6)
>
> (6) *Limitation on amount deductible* —(i) *Claims and expenses paid after the grace period* —(A) *Definitions*. The following definitions apply for purposes of this paragraph (d):
>
> (1) *Grace period*. The *grace period* is the period beginning on the date of the decedent's death and extending through the third anniversary of that date.
>
> (2) *Post-grace-period payment*. A *post-grace-period payment* is the amount of a claim or expense described in paragraph (a) of this section not paid or to be paid before the end of the grace period.
>
> (B) *General rule*. To the extent that a post-grace-period payment otherwise meets the requirements for deductibility of a claim or expense under section 2053 and the regulations in this part thereunder, the amount deductible under section 2053 is limited to the present value, as of the decedent's date of death, of that amount. The present value of each post-grace-period payment is calculated by discounting it from the payment date or expected date of payment to the decedent's date of death. The applicable discount rate is the applicable Federal rate determined under section 1274(d) for the month in which the decedent's death occurs, compounded annually. The length of time from the decedent's date of death to the date of payment or expected date of payment will determine whether the Federal rate applicable to that payment is the Federal mid-term rate or the Federal long-term

> rate. The Internal Revenue Service publishes the applicable Federal rates for each month in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter). Any reasonable assumptions and methodology in regard to time period measurements may be used to calculate, in accordance with paragraph (d)(6)(ii) of this section, the present value of the post-grace-period payment(s).

If there are multiple payments then each is calculated separately. What if the date of payment is unknown? Prop. Reg. §20.2053-1(d)(6)(iii) states:

> (iii) *Discounting when actual date of payment is unknown.* With regard to a post-grace-period payment that may be deducted in advance of payment under paragraph (d)(4) of this section or § 20.2053-4(b) or (c), the amount deductible must be determined by computing the present value of the amount of that post-grace-period payment as if that amount will be paid on the expected date of payment. The expected date of payment in settlement or satisfaction of a claim or expense must be determined using all information reasonably available to the taxpayer to make a fair and reasonable estimate of the expected date or dates of payment. For amounts deductible under § 20.2053-4(b) or (c), the expected date or dates of payment must be identified in a written appraisal document of a person that is qualified by knowledge and experience to appraise the claim being valued. *See* § 20.2053-4(b)(1)(iv) and (c)(1)(iv). However, the computation of present value is subject to adjustment if, within the period described in paragraph (d)(2) of this section, the actual date or dates of payment become known and differ from the estimated date or dates of payment. *See* paragraph (d)(6)(vi) of this section.

Of particular interest, the proposed regulations reduce, and in most instances eliminate, the benefits of long-term loans to pay estate taxes, often referred to as Graegin loans. Section 20-2053-3(d)(2) provides:

> (2) *Interest expense on certain loan obligations of the estate.* Interest on a loan entered into by the estate to facilitate the payment of the estate's tax and other liabilities or the administration of the estate may be deductible depending on all the facts and circumstances. To be a deductible administration expense, interest expense must arise from an instrument or contractual arrangement that constitutes indebtedness under applicable income tax regulations and general principles of Federal tax law. In addition, the interest expense and the loan to which interest expense relates must satisfy the requirement of § 20.2053-1(b)(2) that they are bona fide in nature based on all the facts and circumstances. Further, both the loan to which the interest expense relates and the loan terms must be actually and necessarily incurred in the administration of the decedent's estate and must be essential to the proper settlement of the decedent's estate. *See* paragraph (a) of this section. If the facts and circumstances establish that the interest expense arises from an instrument or contractual arrangement that constitutes indebtedness under general principles of Federal tax law, factors that collectively may support a finding that the interest expense also satisfies the additional requirements under § 20.2053-1(b)(2) and paragraph (a) of this section include, but are not limited to, the following:
>
> (i) The interest rate on and the terms of the underlying loan (whether between related or unrelated parties), including any prepayment penalty, are reasonable given all the facts and circumstances and comparable to an arms-length loan transaction;

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

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

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

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

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

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

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

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

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

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

On the other hand, arguably the proposed regulations are generous regarding guarantees. Section 20.2053-3(d)(5) provides:

> (5) *Claims founded upon a promise* —(i) *In general.* To be deductible, a claim founded on a promise must represent a personal obligation of the decedent existing at the time of the decedent's death, and the claim must be enforceable against the decedent's estate. In addition, except with regard to pledges or subscriptions (*see* § 20.2053-5), the deduction for a claim founded upon a promise or agreement is limited to the extent that the promise or agreement was bona fide and in exchange for adequate and full consideration in money or money's worth; that is, the promise or agreement must have been bargained for at arm's length and the price must have been an adequate and full equivalent reducible to money value.
>
> (ii) *Decedent's promise to guarantee a debt.* A deduction for a claim founded upon a decedent's agreement to guarantee a debt of another is a claim founded on a promise and is subject to the limitation in paragraph (d)(5)(i) of this section. For purposes of section 2053, a decedent's agreement to guarantee a debt of an entity in which the decedent had an interest at the time the guarantee was given satisfies the requirement that the agreement be in exchange for adequate and full consideration in money or money's worth if, at the time the guarantee was given, the decedent had control (within the meaning of section 2701(b)(2)) of the entity. Alternatively, this requirement is satisfied to the extent the maximum liability of the decedent under the guarantee did not exceed, at the time the guarantee was given, the fair market value of the decedent's interest in the entity. The bona fide nature of the decedent's agreement to guarantee a debt of a family member, a related entity, or a beneficiary (as defined in § 20.2053-1(b)(2)(iii)) is determined in accordance with § 20.2053-1(b)(2)(ii). For a claim otherwise deductible under this paragraph (d)(5)(ii), the estate's right of contribution or reimbursement will reduce the amount deductible in accordance with § 20.2053-1(d)(3). Payments made pursuant to the decedent's guarantee of a debt are deductible only to the extent that the debt for which the guarantee is given has not been taken into account in computing the value of the gross estate under § 20.2053-7 or otherwise.
>
> * * * * *
>
> (7) * * *
>
> (iii) The claimant (C) is not a family member, related entity, or beneficiary of the estate of decedent (D), unless otherwise provided, and is not the executor (E).
>
> * * * * *
>
> (J) *Example 10: Guarantee.* On Date 1, D entered into a guarantee agreement with Bank (C) to secure financing for a closely-held business (LLC) in which D had a controlling interest. LLC was solvent at the time LLC executed a promissory note in the amount of $100x in favor of C. Prior to D's death, LLC became insolvent and stopped making payments on the note. After D's death, C filed a claim against D's estate for payment of the remaining balance due under the note and E paid the full amount due. Although E had a right of contribution against LLC for primary payment of the indebtedness, LLC was insolvent and no part of the debt was collectible at the time E deducted the payment. D's estate may deduct the amount paid to C in satisfaction of D's liability under the guarantee agreement. The guarantee agreement is considered to have been contracted for an adequate and full consideration in money or money's worth. The result would be the same if D

> did not have control of LLC as long as the fair market value of D's interest in the LLC on Date 1 was at least $100x.

In many family enterprises, the senior generation will have control and be the guaranteeing party but will have transferred the equity to other family members. On the other hand, where multiple parties pool capital and the enterprise borrows money, no party may have control at all.

Subsequent to 2009, Treasury and the IRS have concluded that the notion of a "qualified appraisal" in valuing a claim against an estate is inappropriate. The Background and Explanation of Provisions provides:

> Section 20.2053-4(b) and (c) provides exceptions to the general rule in § 20.2053-4(a) that an estate may deduct only amounts that actually are paid by the estate in satisfaction of a claim. Section 20.2053-4(b) generally allows a deduction for the value of claims and counterclaims in a related matter, and § 20.2053-4(c) allows a deduction for the value of unpaid claims totaling not more than $500,000. In each case, certain requirements must be satisfied to enable the estate to use these exceptions.
>
> One such requirement is that the value of a claim against the estate that may be deducted under either § 20.2053-4(b) or (c) must be determined from a "qualified appraisal" performed by a "qualified appraiser" within the meaning of section 170 and the regulations thereunder. The Treasury Department and the IRS have reconsidered this requirement. The definition of "qualified appraiser" and "qualified appraisal" in the regulations under section 170 were drafted in the context of appraising an asset being donated, and not a liability such as a claim against an estate. Certain of the elements of a qualified appraisal, including references to the "date of contribution," and the requirements necessary to meet the definition of a "qualified appraiser," do not apply in the context of valuing a claim against an estate for purposes of determining the value to be deducted from the gross estate under section 2053.
>
> The Treasury Department and the IRS have determined that the rule in § 20.2053-4(b) and (c) should be amended to remove the requirement that the value be determined by a "qualified appraisal" performed by a "qualified appraiser" within the meaning of section 170 and the regulations thereunder. Instead, the Treasury Department and the IRS propose to amend the regulations under section 2053 to provide revised rules for valuing claims for purposes of § 20.2053-4(b) and (c).

Instead, section 20.2053-4(b)(1)(iv), as revised, provides:

> (iv) The value of each such claim against the estate is supported by a written appraisal document to be filed with the Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* or successor form, and the written appraisal document—
>
> (A) Adequately reflects post-death events that have occurred prior to the date on which a deduction is claimed on an estate's Form 706;
>
> (B) Reports, considers, and appropriately weighs all relevant facts and elements of value as are known or are reasonably determinable at the time of the appraisal, including the underlying facts of the claim against the estate, potential litigating risks, and the current status of the claim and procedural history;

(C) Takes into account post-death events reasonably anticipated to occur;

(D) Identifies an expected date or dates of payment (for purposes of determining the applicability of the present value limitation in § 20.2053-1(d)(6));

(E) Explains in detail the methods and analysis that support the appraisal's conclusions;

(F) Is prepared, signed under penalties of perjury, and dated by a person who is qualified by knowledge and experience to appraise the claim being valued and is not a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or revocable trust (as those terms are defined in § 20.2053-1(b)(2)(iii)), a family member of a beneficiary or a related entity as to a beneficiary (as those terms would be defined in § 20.2053-1(b)(2)(iii) if references therein to the decedent were replaced with a reference to such beneficiary, and without regard to the limitations in § 20.2053-1(b)(2)(iii) based on the decedent's date of death), or an employee or other owner of any of them; and

(G) Includes a statement providing the basis for the person's qualifications to appraise the claim being valued.

M. SECTIONS 2056, 2056A AND 2519- MARITAL DEDUCTION

1. **Termination of QTIP Trust.** In PLR 202116001 a QTIP ("Qualified Trust") was divided and the spouse released an income right over part of the trust. The ruling describes what happened as follows:

> On Date 1, Trustee divided Qualified Trust into two trusts, Qualified Trust-A and Continuing Qualified Trust, both with terms and provisions identical to those set forth in Qualified Trust. Trustee placed $x in cash and marketable securities into Qualified Trust-A and retained all other assets in Continuing Qualified Trust. The assets retained in Continuing Trust are income producing such that Spouse retains the enjoyment of the assets. On Date 2, Trustee and the beneficiaries of Qualified Trust-A petitioned Court for entry of an order with respect to Qualified Trust-A. On Date 3, finding that a continuation of Qualified Trust-A unchanged would defeat or substantially impair its purposes, Court entered Order. Order modifies the terms and provisions of Qualified Trust-A.
>
> Article V of Qualified Trust-A, as modified by Order, provides that Qualified Trust-A shall terminate upon the death of the last surviving income beneficiary. However, at any time, including prior to Spouse's death, Qualified Trust-A may be terminated as to a beneficiary's interest and any part of the trust property representing her interest may be distributed to that beneficiary if the trustee considers such distribution to be in the best interests of the beneficiary, considering the demonstrated ability of the beneficiary to handle money and property wisely, her judgment, prudence and discretion, and any other factors the trustee may consider relevant. The trustee may exercise the power of termination even if the beneficiary is restrained from alienating her interest.
>
> Article III, section 3.1, as modified by Order, provides that the original and principal beneficiaries of Qualified Trust-A shall become the income beneficiaries in proportion to their interests in the principal. Section 7.2, allowing the trustee to make distributions to Spouse for her health, education, maintenance and support, is deleted in its entirety. Order further provides that, the terms and conditions of

> Qualified Trust-A shall be interpreted and applied as if Spouse had died on the date Order is entered, and that Trustees shall continue to be the trustee of Qualified Trust-A and Continuing Qualified Trust. Although Order is effective on Date 3, it is expressly conditioned on receipt of favorable rulings from the Internal Revenue Service prior to Date 4.

Because the trust continued even after the income interest was given up, there was no gift form the remainder beneficiaries. However, the gift by the spouse was described like this:

> In the present case, following the division of Qualified Trust on Date 1, the trusts resulting from the division, Qualified Trust-A and Continuing Qualified Trust, had terms and provisions identical to those set forth in Qualified Trust. Thus, the division of Qualified Trust did not change the beneficial interests of Spouse, Daughter 1 or Daughter 2 in the property originally held in Qualified Trust. Accordingly, based on the facts submitted and representations made, we rule that the division of Qualified Trust on Date 1 did not cause the assets remaining in Qualified Trust after the division (referred to as Continuing Qualified Trust) to be subject to the United States Gift Tax pursuant to § 2519 or 2511.
>
> Order, however, modifies the terms of Qualified Trust-A to change the beneficial interests of Spouse, Daughter 1, and Daughter 2 in the property of Qualified Trust-A. Article V of Qualified Trust-A, which continues to provide that Qualified Trust-A shall terminate upon the death of the last surviving income beneficiary, is modified to provide that at any time, including prior to Spouse's death, Qualified Trust-A may be terminated as to a beneficiary's interest. In other words, Order terminates Spouse's income interest as of Date 3. The term "disposition" as used in § 2519, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means. See H. Rep. No. 97-201, at 161 (1981). The property in Qualified Trust-A is a portion of the property originally held by Qualified Trust with respect to which Decedent's estate was allowed a deduction under § 2056(b)(7). Thus, for purposes of § 2519, the entry of Order on Date 3 resulted in a disposition of a qualifying income interest for life in Qualified Trust-A.
>
> Accordingly, based on the facts submitted and representations made, we rule that Spouse is deemed to have made a transfer of all of the property in Qualified Trust-A under § 2519, other than the value of her qualifying income interest, and Spouse is deemed to have made a transfer of her qualifying income interest in Qualified Trust-A under § 2511, on Date 3 upon entry of Order approving modifications by which the income interest of Spouse in Qualified Trust-A is terminated and distributions from Qualified Trust-A are permitted to be made prior to death of Spouse.

Today, we have interesting developments in the world of distributing QTIP assets to the spouse beneficiary. First, there is CCA 202118008 where the IRS made a triple-gift claim. That involves an actual case which has now been decided by the Tax Court. Second, we have the Anenberg decision which says NO NO to the IRS in a reviewed and unanimous Tax Court opinion (signed by all 13 currently active judges; there are six vacancies) but does not say NO NO NO.

CCA 202118008 involved simple facts and a most unfortunate result. Surviving spouse was the beneficiary of a QTIP trust, received all the income of course, could receive principal for health, maintenance, and support in the spouse's accustomed standard of living if the income were insufficient, and had a testamentary power of appointment among descendants. Apparently for planning purposes, the spouse and descendants decided to terminate the trust and give all of the trust assets back to the spouse who then disposed of the assets in what appear to be sales and perhaps other estate planning transactions. The National Office determined that spouse made a gift of the value of the QTIP assets when the trust was terminated, and that the descendants made a gift of the value of their remainder interests. There was no offset for the respective gifts, and the transaction was not treated as a sale. The termination was done via a commutation agreement that the CCA describes this way:

> On Date 3, Spouse, as the current beneficiary and as the trustee of Trust 1, and Child 1 and Child 2, as remainder beneficiaries and virtual representatives of the contingent and unborn beneficiaries of Trust 1, entered into Agreement. Under the terms of Agreement, Trust 1 was commuted1 and all of its property was distributed to Spouse. Recital H of Agreement provides that Spouse and Children agree that "Trust assets could be more effectively utilized if [Spouse] held such assets outright and free of trust." In Recital F of Agreement, the parties acknowledge that Spouse's testamentary limited power of appointment is "not operative." Paragraph 3 of Agreement provides:
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>> By signing this Agreement and by virtue of the QTIP election for the Trust, the commutation of the Trust results in a deemed gift, for federal gift tax purposes, of the remainder interest in the Trust assets from [Spouse] to [Children] under Section 2519 of the Code. By virtue of the distribution of all of the Trust assets to [Spouse], the commutation of the Trust does not result in a deemed gift of [Spouse's] income interest in the Trust under Section 2511 of the Code. Additionally, by signing this Agreement and by virtue of the distribution of all of the Trust asset [sic] to [Spouse], the commutation of the Trust results in a gift, for federal gift tax purposes, of the remainder interest in the Trust from [Children] to [Spouse]. The deemed gift of the remainder interest from [Spouse] to [Children] and the gift from [Children] to [Spouse] results in a reciprocal gift transfer.

First up to be considered were the tax consequences to the spouse. The CCA states:

> In this case, Spouse, as personal representative of Decedent's estate, made an election under § 2056(b)(7) to treat Trust 1 as QTIP and claimed a marital deduction on Decedent's Form 706 for the value of Trust 1. Years later, on Date 3, Spouse and Children entered into Agreement. By its terms, Agreement effected the commutation of Trust 1.
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> In a commutation, the trustee makes terminating distributions to the holders of the beneficial interests in the trust equal to the actuarial value of the interests. Each beneficiary gives up his or her respective beneficial interest in exchange for a lump sum payment, in what is essentially a sale transaction. The commutation terminates any relationship between the beneficiary and the trust, and if all interests are commuted, the trust terminates.
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> Based on the above, the commutation of Trust 1 effected by Agreement constitutes a disposition by Spouse of Spouse's qualifying income interest within the meaning of § 2519(a). Section 25.2519-1(a) and (f); *Estate of Novotny*. Accordingly, for gift tax purposes, Spouse is treated as transferring by gift all interests in Trust 1 other than the qualifying income interest.3

Footnote 3 states:

> Note that the commutation does not constitute a gift of Spouse's qualifying income interest under § 2511 because Spouse received adequate and full consideration for Spouse's qualifying income interest based on the distribution of all trust property to Spouse. *See* § 25.2519-1(g), *Example 2*.

The CCA summarized the Estate of Novotny, 93 T.C. 12 (1989) like this: the surviving spouse and remainderman divided the sale proceeds of QTIP proportionately on the basis of the respective values of their interests; the court indicated that the commutation constituted a disposition by the spouse of the income interest for purposes of § 2519 and was thus subject to gift tax.

So, the QTIP was terminated, the spouse received all the QTIP assets, and the spouse made a gift of the value of those assets to the descendants. Now let's look at the what the descendants did. Before the termination they would have received the assets when the spouse died. The CCA provides as follows:

> In this case, Child 1, Child 2, and Spouse entered into Agreement, which legally bound all persons interested in Trust 1. The effect of Agreement was to extinguish Spouse's testamentary limited power of appointment, commute Trust 1, and terminate Trust 1. As a result, Agreement vested a valuable property interest (the value of the remainder) in Children, the then remaindermen. Rather than accept a terminating distribution of the value of their beneficial interest, Child 1 and Child 2 agreed that the trust property "could be more effectively utilized" by Spouse holding the property outright. The outright distribution of all trust property to Spouse pursuant to the terms of Agreement constitutes a transfer of the value of Children's remainder interests without receipt of adequate and full consideration.4 Accordingly, Child 1 and Child 2 each made a gift under § 2511 of the value of their respective remainder interest in Trust 1 to Spouse. Section 2512(b).

Footnote 4 is omitted and deals with spouses' subsequent transfers.

The children argued that there had to be some offset here, otherwise the property was being taxed twice. The National Office rejected that position stating:

> In *Commissioner v. Wemyss*, 324 U.S. 303 (1945) and its companion case *Merrill v. Fahs*, 324 U.S. 308 (1945), the Supreme Court considered the gift tax meaning of the term "adequate and full consideration in money or money's worth" in the context of antenuptial contracts.
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> In *Wemyss*, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and, if the fiancé's loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor. The Supreme Court stated:

If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for "adequate and full (money) consideration" aims to reach those transfers which are withdrawn from the donor's estate.

Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor's taxable estate.

In *Merrill,* the donor transferred property to donor's then spouse in exchange for spouse's relinquishment of marital rights in donor's remaining property. The Court held that spouse's relinquishment of the marital rights did not constitute adequate and full consideration for donor's transfer because the assets subject to the marital rights were already includible in donor's gross estate. *Id*. at 312-13.

Rev. Rul. 69-505, 1969-2 C.B. 179, involves a transfer to a trust of joint-tenancy property that is treated as a reciprocal exchange for consideration in money or money's worth. A and B owned the property as joint tenants and could each unilaterally sever the joint tenancy, and if not severed, the property would pass to the survivor upon the death of the other joint tenant. A and B transferred the property to a trust, reserving the right to receive one-half of the income therefrom for their joint lives and all to the survivor for life with remainder to C. Citing § 25.2511-1(e) and *U.S. v. Estate of Grace*, 395 U.S. 316 (1969), the revenue ruling holds that the transfers between A and B are treated as a reciprocal exchange for consideration in money or money's worth. Thus, neither A nor B made a gift to the other to the extent that the transfers were of equal value. The revenue ruling concludes that since the value of the gift by B is less than the value of the gift by A, A is deemed to have made a gift to B of the difference in value of A's and B's transfer.

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Agreement characterized the transaction as a commutation of Trust 1 followed by a distribution of all trust property to Spouse. Thus, Spouse agrees to the extinguishment of Spouse's lifetime interest in Trust 1 and Children agree to the extinguishment of their remainder interest in Trust 1 in exchange for receipt of their respective proportionate share of trust property. Also pursuant to Agreement, Children transfer their proportionate share of trust property received in the commutation to Spouse and receive no consideration from Spouse in exchange for the transfer. Absent entering into Agreement, Spouse had no right to the remainder under the terms of Trust 1 or otherwise. Therefore, from an economic perspective, the transaction resulted in a one-sided gift transfer from Children to Spouse.

It is the deemed gift transfer arising by application of § 2519(a) that is the crux of Spouse and Children's position, as stated in Agreement, that the transfers are reciprocal gift transfers. However, unlike in Rev. Rul. 69-505, Spouse's deemed transfer under § 2519(a) and Children's transfers of their remainder interests under § 2511 do not constitute offsetting exchanges of consideration. Spouse received no consideration for the deemed transfer to Children under § 2519(a). That is, because the entire value of Trust 1 was subject to inclusion in Spouse's gross estate under § 2044, the transfer of the remainder by Children to Spouse does not augment Spouse's estate and, thus, cannot constitute the receipt of adequate and full consideration for gift tax purposes. *See Commissioner v. Wemyss; Merrill v. Fahs.*

The fact that Spouse can receive no consideration for the deemed transfer resulting from the application of § 2519(a) does not nullify Children's transfers of their remainder interests in Trust 1. When Trust 1 was commuted, the remainder interest vested outright, equally in Children, the then remaindermen. Children then transferred their valuable property interest to Spouse and received nothing in exchange. Under § 2512(b) and *Wemyss*, these transfers by Children for no consideration constitute a gift. If Children were to transfer their remainder interests to a third party other than Spouse, the transfers would clearly be a gift. The result is the same if the donee is the surviving spouse beneficiary of a QTIP trust.5 Thus, the transaction cannot be considered involving offsetting transfers for consideration within the meaning of Rev. Rul. 69-505.

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In Rev. Rul. 98-8, 1998-1 C.B. 541, the surviving spouse purchased from the trust remainderman the remainder interest in a QTIP trust by issuing a promissory note equal to the actuarial value of the remainder interest to the remainderman. As a result of the purchase, the trust terminated under its terms and the entire corpus was transferred to the surviving spouse. The surviving spouse then used the proceeds to pay the remainderman the value of the remainder interest. The revenue ruling concludes that the purchase of the remainder interest, which is analogous to a commutation of the QTIP trust, is treated as a taxable disposition by the surviving spouse of the qualifying income interest, resulting in a gift of the value of the remainder interest under § 2519. Citing to *Wemyss*, the revenue ruling explains that the receipt of the remainder interest cannot increase the donor's taxable estate because it is already subject to inclusion in the surviving spouse's taxable estate under § 2044. Accordingly, the surviving spouse's receipt of the remainder interest cannot constitute adequate and full consideration under § 2512 for the promissory note transferred. The revenue ruling notes that any other result would subvert the legislative intent and statutory scheme underlying § 2056(b)(7).

In *Estate of Kite v. Commissioner*, T.C. Memo. 2013-43, the surviving spouse was the beneficiary of two QTIP trusts. According to a prearranged plan, the QTIP trusts were terminated and all assets were distributed to the surviving spouse. Two days later, the surviving spouse sold the assets to her three children in exchange for three deferred private annuity agreements under which payments would commence ten years thereafter. In the event that the surviving spouse died within the ten-year period, her annuity interest would terminate and nothing would be payable to her estate. Based on the facts and circumstances, the court found the sale of the assets of the QTIP trusts to the children in exchange for deferred annuities constituted a bona fide sale for adequate and full consideration and treated the annuity transaction as a single integrated transaction for purposes of § 2519. Moreover, the sale of the assets of the QTIP trusts, followed by the payment to the surviving spouse of the proceeds equal to the value of her income interest, was a disposition of her qualifying income interest for purposes of § 2519. In response to petitioner's post-opinion argument that there was no gift tax deficiency for the § 2519 disposition of the surviving spouse's qualifying income interest based on the receipt of full and adequate consideration, the court stated,

> [S]ection 2519(a) treats the disposition of a qualifying income interest as a deemed transfer of the remainder interest. In other words, "the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest" (emphasis added). Sec. 25.2519-

> 1(a), Gift Tax Regs. The term "gift" is not an accident. The remainder interest is a future interest held by the remainderman and not the donee spouse. Accordingly, the donee spouse cannot receive full and adequate consideration, or indeed any consideration, in exchange for the remainder interest. This result is supported by the intent of the marital deduction and the QTIP regime.

> *Estate of Kite v. Commissioner*, No. 6772-08 (T.C. Oct. 25, 2013) (order and decision under Tax Court Rule 155). The court ruled that the decedent owed gift tax on the value of the deemed § 2519 gift. *Id*.
>
> Here, the QTIP statutory scheme and legislative history support the view that Rev. Rul. 69-505 has no application and the separate transfers by Spouse and Children cannot be offset by consideration for gift tax purposes. Decedent's estate received the benefit of deferral of the estate tax liability allocable to the property of Trust 1 as a result of electing QTIP for such property under § 2056(b)(7). Because the commutation effected by Agreement constitutes a taxable disposition by Spouse within the meaning of § 2519(a) (see Issue 1), it marks the end of the deferral of the tax.
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> Rev. Rul. 98-8 and *Estate of Kite* illustrate that a disposition under § 2519(a) has significant tax consequences, which are appropriate in view of the QTIP statutory scheme and legislative history. Here, because the commutation of Trust 1 results in a disposition of Spouse's qualifying income interest within the meaning of § 2519(a), Spouse is treated as effectively transferring the remainder interest even though under state property law precepts the remainder interest is held by Children, not Spouse. The taxable transfer by Spouse resulting from the application of § 2519 marks the end of the deferral of estate tax on the Trust 1 property that passed untaxed from Decedent's estate, and is no longer subject to inclusion in Spouse's gross estate under § 2044(b)(2). Eliminating the taxable transfer by Spouse based on a deemed reciprocal gift transfer by the remaindermen would allow the value of the remainder of Trust 1 to escape transfer tax under both §§ 2519 and 2044, which would be contrary to the QTIP statutory scheme and legislative history.

Finally, the National Office got around to valuing the two gifts. The spouse's gift – recall that the spouse received all the property – was valued by subtracting the spouse's income interest from the full value of the trust property. The children's gifts were valued based on standard actuarial methods. The CCA states:

> Section 25.2519-1(c)(4) provides that the amount treated as a transfer under § 25.2519-1(c)(1) is further reduced by the amount the surviving spouse is entitled to recover under § 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). Under § 25.2519-1(c)(4), if the donee spouse is entitled to recover gift tax under § 2207A(b), the amount of the gift tax recoverable and the value of the interest treated as transferred under § 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).
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> Under § 2207A(b) and § 25.2207A-1(a), a surviving spouse treated as transferring an interest in property by reason of § 2519 is entitled to recover from the "person receiving the property" the amount of gift tax attributable to that property. The right of recovery arises at the time the gift tax is actually paid by the surviving spouse subject to § 2519.

> In this case, the amount of Spouse's gift under § 2519 is determined by subtracting the value of Spouse's qualifying income interest from the fair market value of the trust property as of Date 3, the date of Agreement. Section 2519(a); § 25.2519-1(a). Discretionary principal distributions and the testamentary limited power of appointment are not taken into account. A standard § 7520 income factor can be used to value the qualifying income interest, and thus, the value of Spouse's qualifying income interest is determined by multiplying the value of the trust property by the income factor of
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> 0.09172.6 Section 25.2512-5(d)(2)(iii); § 25.7520-1. Based on a value of the trust property of $b, the value of Spouse's qualifying income interest is $e. The amount of Spouse's gift under § 2519, therefore, is $f (i.e., $b – $e = $f).
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> To the extent Spouse is entitled to recover gift tax attributable to the remainder interest under § 2207A(b), this amount is reduced, using an interrelated calculation. Note that, under § 25.2207A-1(b), if Spouse waives or otherwise fails to exercise Spouse's right of recovery, Spouse will be treated as making an additional gift in the amount of the unrecovered tax.7
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> Based on the available facts, it is appropriate to value each of Children's interests as one-half of the actuarial present value of the remainder interest, adjusting as necessary for the restrictions on the beneficial interests. The determination takes into account that the possibility of principal invasion was so remote as to be negligible, given that the combined value of the property held by Trust 1 was $b at the time of commutation and, thus, annual income of Trust 1 would have been substantial and likely sufficient for Spouse's health, maintenance, and support, even if Spouse's accustomed manner of living were extravagant.8 Further, the determination takes into account, based on all the facts and circumstances, that the testamentary limited power of appointment would be appropriately treated as having no measurable effect on the values of these interests.
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> Accordingly, based on the available facts, we conclude that the actuarial value of Children's proportionate shares of the remainder interest is properly determined under § 7520, using a standard remainder factor. Thus, the value of each child's remainder interest under § 7520 is determined by multiplying the value of the trust property by the remainder factor of 0.908289 then dividing the product by 2. Section 25.2512-5(d)(2)(ii); § 25.7520-1. Based on a value of the trust property of $b, the fair market value of each child's gift, therefore, is $g (i.e., ($b x 0.90828) ÷ 2 = $g).

Footnote 8 notes that the spouse must not have needed principal distributions because the spouse sold most of the assets received "immediately after Spouse received it in exchange for promissory notes that did not provide for the payment of principal until a date after Spouse's probable life expectancy."

The Tax Court case involved in the ruling is McDougall v. Commissioner, which is discussed below.

The Tax Court in a unanimous opinion, Estate of Anenberg, 162 T.C. No. 9 (2024), by the 13 active Tax Court judges has rejected the various QTIP theories of the IRS. Where a surviving spouse receives all the QTIP property there is no gift, and once a QTIP terminates section 2519 ceases to apply. The court lays out the marital deduction and QTIP as follows, in a form that largely dictates the ultimate result:

> TORO, Judge: In this gift tax case, we are called upon to interpret complex provisions concerning the taxation of transfers between spouses. For many years, Congress has treated spouses as a single economic unit for estate and gift tax purposes. As an example, marital gifts between spouses generally are not subject to the gift tax. *See* I.R.C. § 2523(a).1 And when one spouse dies, any assets passing to the surviving spouse generally are not subject to the estate tax, because their value may be deducted from the decedent's gross estate (marital deduction). *See* I.R.C. § 2056(a). Thus, transfer taxes on marital assets typically are deferred until the death of the surviving spouse—that is, until the value of the assets leaves the marital unit. *See Estate of Morgens v. Commissioner*, 133 T.C. 402, 410 (2009), *aff'd*, 678 F.3d 769 (9th Cir. 2012).
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> But this treatment is subject to exceptions. For example, the marital deduction generally is unavailable for a temporary interest (such as a lifetime interest) passed to a surviving spouse. *See* I.R.C. § 2056(b). This rule is designed to prevent the value of the interest from escaping tax altogether, first by being deducted from the decedent's gross estate and then (as in the case of a lifetime interest) terminating before its inclusion in the surviving spouse's estate.
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> Congress has, however, provided an option for taxpayers seeking to bequeath temporary interests to their spouses while still taking advantage of the marital deduction. Such circumstances are governed by the "qualified terminable interest property" (QTIP) regime. I.R.C. § 2056(b)(7). The QTIP rules permit the estate of a decedent who leaves a qualifying lifetime property interest to a surviving spouse—often while leaving the remainder interest to the decedent's children—to take the marital deduction for the full value of the QTIP.2 For these purposes, the rules create a legal fiction under which the surviving spouse is treated as receiving all of the QTIP, when in reality the surviving spouse has acquired only a lifetime income interest in that property.
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> Here we must decide what happens when taxpayers subject to the QTIP regime take steps to conform their actual legal arrangements to the regime's legal fiction. Specifically, the parties' Cross-Motions for Partial Summary Judgment address the treatment of interests in property designated to be treated as QTIP when Alvin Anenberg (Alvin), the husband of Sally J. Anenberg (Sally), passed away. The underlying property was held in trust. Following Alvin's death, Sally obtained a qualifying income interest for life, and, upon her death, the remainder interests in the corpus would contingently go to trusts for the benefit of Alvin's children. But eventually, with the consent of both Alvin's children and Sally, the trusts holding the underlying property were terminated by a state court and all the property held by the trusts was distributed to Sally, putting her in the position she would have been in if all that property had originally passed from Alvin to her. Sally later gifted and sold different pieces of the underlying property to Alvin's children and grandchildren. Eventually, Sally passed away, leaving the gift tax consequences of these transactions to be resolved by her estate (Estate).
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> In his Motion, the Commissioner of Internal Revenue (Commissioner) argues that, under section 2519, the transactions we just described resulted in gift tax liability for Sally. The Estate disagrees in its own Motion. For reasons we describe further below, we agree with the Estate.

The court carefully distinguished between the terms of section 2519, which provides a disposition of an income interest is a <u>transfer</u>, and the circumstances in which a transfer is a <u>gift</u>:

There is some question as to whether the termination of the Marital Trusts (through which Sally held her qualifying income interest for life in the Al-Sal shares) and the distribution of the Al-Sal shares to Sally by order of the Superior Court was a disposition within the meaning of section 2519(a).13 *See, e.g.*, *Rome I, Ltd. v. Commissioner*, 96 T.C. 697, 704 (1991) (discussing the plain meaning of the term "disposition"); *see also Disposition*, *Black's Law Dictionary* (5th ed. 1979) ("Act of disposing: transferring to the care of possession of another. The parting with, alienation of, or giving up property.").14 But we need not resolve this question because, even if the termination of the Marital Trusts and distribution of the Al-Sal shares was a disposition under section 2519(a), we conclude it did not result in gift tax liability for Sally.

As we have discussed, section 2519 provides that, if Sally disposed of all or part of her qualifying income interest for life in the Al-Sal shares, then, for purposes of determining her gift tax liability, she is treated as transferring all the interests in the Al-Sal shares other than her qualifying income interest.15 So far, so good.

A transfer alone, however, is insufficient to create a gift tax liability. Rather, section 2501 tells us that gift tax applies "on the *transfer* of property *by gift* during [the] calendar year." I.R.C. § 2501(a)(1) (emphasis added); *Irvine*, 511 U.S. at 232; *see also Estate of Howard v. Commissioner*, 910 F.2d 633, 636 (9th Cir. 1990) (construing the provisions governing QTIPs and observing that "[i]n a statute so carefully crafted every difference counts"), *rev'g* 91 T.C. 329 (1988). And, as the Supreme Court observed in *Irvine*, "[w]e have repeatedly emphasized that [the Code's] comprehensive language was chosen to embrace all *gratuitous* transfers." *Irvine*, 511 U.S. at 232–33 (emphasis added); *id.* at 235 ("[T]he capacious language of Internal Revenue Code §§ 2501(a)(1) and 2511(a) ... encompasses all *gratuitous* transfers of property and property rights of significant value." (Emphasis added.)). In other words, a gratuitous transfer—not just a transfer—is required to impose gift tax.

Applying these principles to this case is simple. If we assume that Sally's relinquishment of her interest in the Marital Trusts in exchange for the Al-Sal shares was a disposition, section 2519(a) treats her as having transferred away (but not necessarily by gift) all the interests in the Al-Sal shares other than her qualifying income interest. *See also* Treas. Reg. § 25.2519-1(a). The value of the deemed transfer is the fair market value of the shares, less Sally's qualifying income interest. *See id.* para. (c)(1). To determine whether Sally is liable for any gift tax on this deemed transfer, we must consider whether the transfer was also a gift by Sally.

This task turns out to be straightforward. To determine whether Sally made a gift, in connection with the deemed transfer, we compare what she had before and after the transaction. When doing so, we find that, after the transaction, Sally had full ownership of the Al-Sal shares. As a result of the Superior Court's order, she received free and clear the underlying property that section 2056(b)(7) deemed her to have received from Alvin to start with and with respect to which (we assume) section 2519(a) deemed her to have transferred remainder interests upon the termination of the Marital Trusts. Put another way, Sally's deemed transfer of the remainder interests in the Al-Sal shares held in trust (other than her qualifying income interest) resulted in her actual receipt of all the Al-Sal shares unencumbered (other than those attributable to her qualifying income interest). At the end of the day, she gave away nothing of value as a result of the deemed transfer. Accordingly, the termination of the Marital Trusts did not result in any "gratuitous transfers" by Sally, deemed or otherwise. *See Irvine*, 511 U.S. at 232. Because there was no gratuitous transfer, she made no gift. A long line of cases

> echoes this principle. *See, e.g.*, *Turman v. Commissioner*, 35 T.C. 1123, 1129 (1961) (holding that a surviving spouse made no gift when she took under her husband's will and thereby gave up her one-half interest in their community property because the value of property she gave up (the one-half interest) was less than what she received in return (a life estate in all the community property)); *Siegel v. Commissioner*, 26 T.C. 743, 747 (1956) (stating on similar facts that "[i]f [the taxpayer] received more than she surrendered then, of course, no gift has been made"), *aff'd*, 250 F.2d 339 (9th Cir. 1957).
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> Considering the circumstances that existed when the Superior Court directed the trustee of the Marital Trusts to transfer all of the assets of those trusts to Sally free and clear, we see the following. Before the termination of the Marital Trusts, Sally held a qualifying income interest for life in the QTIP. She was deemed for estate and gift tax purposes to hold the remainder interests as well. But these interests, even when considered together, did not equate to unencumbered ownership. She was not free to do what she wished with the QTIP, which was held in the trusts. After the Superior Court order, Sally received the QTIP free of any trust restrictions. In these circumstances, to the extent section 2519 viewed Sally as transferring away the interests in property that the QTIP regime treated her as holding in the first place, it is hard to understand why Sally would not have received full and adequate consideration in return when she was also at the receiving end of the transfer of the property unencumbered. Before the Marital Trusts terminated, she actually held an income interest in the Marital Trusts' property valued at approximately $2.6 million, but was deemed to hold the entirety of the Marital Trusts' property valued at approximately $25.5 million. Immediately after the Marital Trusts terminated and (we assume) Sally was deemed to transfer the residual value of the Marital Trusts' property (approximately $22.9 million), she actually held assets valued at approximately $25.5 million. Sally could thus be viewed as fully compensated for whatever interest she was deemed to transfer.
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> In sum, when looking for a gratuitous transfer in the circumstances here, one comes up short. Simply put, Sally made no gift. So, while (we assume) there was a transfer, there was no transfer of property *by gift*, a predicate for the Code's imposition of gift tax. *See* I.R.C. § 2501(a)(1).

Interestingly, the court also analogized the transaction as akin to an exercise of a power of appointment over the QTIP in favor of the spouse:

> The termination of the Marital Trusts is similar to an appointment of the assets of the Marital Trusts to Sally—i.e., an assignment of ownership in the assets to her. *See, e.g.*, Cal. Prob. Code § 610(f) (West 2023) (defining a "power of appointment" as "a power that enables a powerholder ... to designate a recipient of an ownership interest in ... property"); *see also Power of Appointment*, *Black's Law Dictionary* (5th ed. 1979) (defining a "[p]ower of appointment" as "[a] power ... to appoint, that is, to select and nominate, the person or persons who are to receive and enjoy an estate or an income therefrom"). Perhaps in recognition that it would make little sense to impose the gift tax when property owned (or deemed owned) by the surviving spouse is distributed to her for her own use, the governing regulations provide that appointment of the QTIP to the surviving spouse is not treated as a disposition under section 2519. *See* Treas. Reg. § 25.2519-1(e) ("The exercise by any person of a power to appoint [QTIP] to the donee spouse is not treated as a disposition under section 2519, even though the donee spouse

> subsequently disposes of the appointed property."); *cf.* I.R.C. § 2056(b)(7)(B)(ii)(II) (providing that a surviving spouse can hold a qualifying income interest for life in QTIP only when "no person has a power to appoint any part of the property to any person *other than the surviving spouse*" (emphasis added)). As a result, no gift tax applies in the event of an appointment. We see no reason to reach a contrary result here, where as a result of the Superior Court's order the Marital Trusts distributed the QTIP to Sally by analogous means.
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> The Commissioner would have us treat the circumstances here the same from a gift tax perspective as we would treat a termination of the Marital Trusts that was followed by a hypothetical distribution to Sally of the value of her qualifying income interest only, with the value of the remainder interests distributed to Steven and Neil. But the two situations are not remotely the same. *See, e.g.*, *Merrill v. Fahs*, 324 U.S. 308, 311 (1945) ("The guiding light is ... [that] '[t]he gift tax [i]s supplementary to the estate tax. The two are in *pari materia* and must be construed together.' " (quoting *Estate of Sanford v. Commissioner*, 308 U.S. at 44)).

The Kite case is distinguished, but weakly, perhaps because Kite itself is hard to understand on the QTIP termination point:

> The Commissioner also makes much of *Estate of Kite*, T.C. Memo. 2013-43. In that case, we considered a surviving spouse (Mrs. Kite) who, like Sally, acquired an income interest in QTIP upon the death of her spouse. *Id.* at *36. The QTIP was held in a trust. Eventually that trust was terminated, and the entire interest in the trust property was distributed to another trust created for Mrs. Kite's benefit. *Id.* at *39. Two days later, Mrs. Kite's trust sold the entirety of the property to her spouse's children, receiving private annuity agreements in return. *Id.* at *39–40. In relevant part, the private annuity agreements were unsecured, and the first payments were not due until 10 years after the sale. *Id*. at *40. The annuities were structured in such a way that, if Mrs. Kite (who was in her 70s at the time and receiving in-home medical care) died before the first payments were due, then "her annuity interest would terminate" and the income from the annuities (which the Court determined were adequate and full consideration for the qualified terminable interest property) would no longer be part of her gross estate and would escape estate tax. *Id.* at *13. And in fact, Mrs. Kite did die before any annuity payments were made. *Id.* at *17.
>
> On these facts and assuming the form of Mrs. Kite's transactions were respected, the value of the QTIP that was deemed to pass to Mrs. Kite (and for which a marital deduction had been taken) would have escaped estate and gift tax altogether. Observing that the form of the transaction would allow Mrs. Kite's estate to "circumvent the QTIP regime" and "avoid any transfer tax," this Court (at the Commissioner's urging) applied the substance over form doctrine to treat the transactions as one integrated transaction. *Id.* at *40–43. And, in doing so, the Court concluded that the termination of the trust and subsequent sale of property was a disposition for purposes of section 2519(a). *Estate of Kite*, T.C. Memo. 2013-43, at *41.
>
> The case before us differs in material respects from *Estate of Kite*. To begin, the Commissioner has not asked that we apply the substance over form doctrine. Moreover, like the Commissioner's other authorities, *Estate of Kite* involved an apparent attempt to prevent estate or gift tax from ever being imposed on the

> residual value of the QTIP for which a marital deduction had been taken. Neither circumstance is present here, so *Estate of Kite* provides the Commissioner no help.

The opinion is clear that a different result could have followed if the spouse had received less than all of the QTIP assets. From a state law perspective, a spouse who receives assets of a QTIP outright because the trust is terminated has more rights than when the assets were in the trust. However, from a tax perspective the termination of the trust does not affect the amount in the spouse's estate. The opinion notes in footnote 18 that it expresses no opinion on whether the other beneficiaries made a gift to the spouse in consenting to the termination. That issue was not raised by the IRS in Anenberg but was at issue in McDougall, 163 T. C. No. 5 (2024), another reviewed opinion, also written by Judge Toro. Once again, the Tax Court concluded that the spouse (Bruce) did not make a gift when the QTIP was terminated in favor of the spouse, but determined that the remainder beneficiaries DID make gifts. The opinion states:

> Unlike in *Estate of Anenberg*, however, here the Commissioner also determined deficiencies against the holders of the remainder interests, Linda and Peter. The Commissioner argues that "[w]ith regard to Linda and Peter, there is no [QTIP] tax fiction at work." Resp't's Mem. 72. Rather, he says, "[t]hey received a remainder interest in the Residuary QTIP Trust assets at Clotilde's death." *Id*. The Commissioner observes that "[t]his is a valuable property interest that became part of their estates at that time, and with respect to which they agreed to an immediate transfer to Bruce pursuant to the Nonjudicial Agreement." *Id*. The Commissioner reminds us "that federal gift tax is an excise tax on the transfer of property," and he concludes that "the transfers of Linda['s] and Peter's rights to a pro rata share of the Residuary QTIP Trust assets are taxable gifts." *Id*. He reasons that, "[b]ecause the assets are no longer part of either of their taxable estates and cannot be further transferred by Linda and Peter, they are no longer subject to further transfer taxation therein." *Id*. at 72–73.
>
> The Commissioner's argument is well taken. Under the "gratuitous transfer" framework described in *Estate of Anenberg*, Linda and Peter plainly made gratuitous transfers. Before the implementation of the Nonjudicial Agreement, they held valuable rights, i.e., the remainder interests in the QTIP.[6] After the implementation of that agreement, which required their consent, Linda and Peter had given up those valuable rights by agreeing that all of the Residuary Trust assets would be transferred to Bruce. And they received nothing in return. By giving up something for nothing, Linda and Peter engaged in quintessential gratuitous transfers and are therefore subject to gift tax under sections 2501 and 2511. *See Estate of Anenberg*, 162 T.C., slip op. at 14–15; *see also Jewett v. Commissioner*, 455 U.S. 305, 310 (1982) ("Our expansive reading of the statutory language [of section 2501] in *Smith* [*v. Shaughnessy*, 318 U.S. 176, 180 (1943)] unquestionably encompasses an indirect transfer, effected by means of a disclaimer, of a contingent future interest in a trust.").[7]

Footnote 7 contains the seemingly obligatory "we do not of course decide here the value of gifts Linda and Peter made to Bruce." That's a factual determination that will have to be determined later.

The court specifically rejected the contention that because of the QTIP election only the surviving spouse has an interest in the QTIP property:

> We have already recognized that the QTIP fiction does not apply for all purposes. *See Estate of Mellinger v. Commissioner*, 112 T.C. 26, 36–37 (1999) ("Neither section 2044 nor the legislative history indicates that decedent should be treated as the owner of QTIP property for [purposes of aggregating stock ownership in connection with valuing the stock]."). This principle is entirely consistent with the function of the QTIP regime—"namely, not eliminating or reducing tax on the transfer of marital assets out of the marital unit, but rather permitting deferral [of that transfer tax] until the death of or gift by the surviving spouse." *Estate of Anenberg*, 162 T.C., slip op. at 20. All the provisions through which Congress enacted the QTIP regime are focused on deferring, imposing, and collecting that single tax. *See, e.g.*, I.R.C. § 2056(b)(7) (permitting through an estate tax deduction deferral of the transfer tax on assets leaving the marital unit); I.R.C. § 2519 (triggering the deferred transfer tax if the surviving spouse makes an inter vivos gift of a portion of the QTIP); I.R.C. § 2044 (triggering the deferred transfer tax on the QTIP when the surviving spouse dies); I.R.C. § 2207A (providing rules for the collection of the deferred transfer tax once it is triggered). Again, the focus of these rules is on the transfer of marital assets outside the marital unit. As the Commissioner points out, they say nothing about, and do not apply to, transactions that transferees outside the marital unit, such as Linda and Peter, may undertake with respect to their own interests in QTIP.
>
> In short, Linda and Peter cannot invoke the QTIP fiction, which applies for the limited purpose of determining Bruce's transfer tax liability when marital assets l to escape transfer tax on their own transactions.

Judge Halpern penned a concurrence in which he noted that it is inconsistent to say that the remainder beneficiaries provided Bruce with adequate and full consideration under section 2519 – which is why Bruce made no gift – and to say that the remainder beneficiaries made a gift to Bruce. Instead, Judge Halpern would have concluded that Bruce only disposed of his income interest; the concurrence states:

> In Revenue Ruling 98-8, 1998-1 C.B. 541, 542, the Internal Revenue Service took the position that "[t]he term 'disposition,' as used in § 2519, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means." The ruling purports to rely on H.R. Rep. No. 97-201, at 161 (1981), *as reprinted in* 1981-2 C.B. 352, 378, which states that property subject to a QTIP election is subject to transfer taxes if the surviving spouse "disposes (either by gift, sale, or otherwise) of all or part of the qualifying income interest." The committee report does not support the broad reading that Revenue Ruling 98-8 gives to the term "disposition." It indicates only that the term is not limited to gifts and sales. It does not follow that any termination of a qualifying income interest, by any means, is a disposition.
>
> ***
>
> If the commutation of the Residuary Trust and the distribution of all trust property to Bruce did not effect a "disposition," within the meaning of section 2519(a), of Bruce's qualifying income interest in the Residuary Trust property, then Bruce cannot be treated under that section as having transferred all the interests in that property other than his qualifying income interest. Linda's and Peter's constructive transfers to Bruce cannot have provided adequate and full consideration to Bruce for a transfer he did not make. If section 2519(a) did not apply, we would have no occasion to impose asymmetrical treatment on a single

> exchange, treating Linda's and Peter's constructive transfers to Bruce as, simultaneously, (1) adequate and full consideration to him for a deemed transfer by him to Linda and Peter, and (2) wholly gratuitous, and thus taxable gifts by them to him. If Bruce made no deemed transfer under section 2519(a) to Linda and Peter, then, as the majority concludes, he made no taxable gifts to them, and their "very real" transfers to him stand alone as taxable gifts.
>
> Again, concluding that Bruce made no section 2519(a) disposition of his qualifying income interest in the Residuary Trust property, in my judgment, provides a sounder basis for the conclusions the majority reaches. The analysis I suggest does not depend on treating a surviving spouse as receiving consideration for a deemed transfer for property he does not actually own—a transfer that is entirely a fiction created by the QTIP rules. Moreover, that analysis does not depend on treating a single exchange differently from the perspective of the transferors and the transferee. The majority views as "complicated" the "question of whether implementing the Nonjudicial Agreement gave rise to 'any disposition' of Bruce's qualifying income interest for purposes of section 2519(a)." Op. Ct. p. 11 n.5. I do not share the majority's reluctance to answer that question. Instead, I view the questions the majority takes on as more complicated than the disposition question. Concluding that the implementation of the Nonjudicial Agreement did not effect a disposition of Bruce's qualifying income interest provides a more straightforward justification for the conclusions that Bruce did not make a taxable gift but Linda and Peter made taxable gifts to him.

Consideration should be given to giving an independent trustee broad discretion over QTIP assets, or to giving someone a power of appointment in favor of the spouse during the spouse's lifetime. With respect to existing trusts, choices are limited. The most reasonable course of action would seem to be to have the trustee make a distribution to the spouse with the recognition that there may be an argument in the future with the IRS over whether the amount distributed was within the prescribed standard. Typically, the statute of limitations will not run on complaints by the remainder beneficiaries against the trustee until after the spouse has transferred assets to those remainder beneficiaries as part of the spouse's estate planning. If those are the facts – which will not be true if the spouse transfers assets to beneficiaries other than the remainder beneficiaries – then a question would be what claims the beneficiaries would reasonably pursue because of the lack of damages. (Could the beneficiaries sue the trustee for a breach, only be awarded $1 in nominal damages when the court learned that the beneficiaries actually received all the trust assets? If so, would $1 be the amount of the gift by the remainder beneficiaries?)

The value of gifts by the remainder beneficiaries is uncertain. What is the effect of a power of appointment? Does it matter what the likely exercise, or not, of the power will be? How are gifts "apportioned" among beneficiaries? Are there gifts by unborn beneficiaries, and what does that mean under the gift tax system?

As a theoretical matter, how the government can simultaneously claim that a spouse cannot buy the remainder interest in a QTIP (Rev. Rul. 98-8), yet the remaindermen cannot give up the remainder interest without making a gift is puzzling.

2. <u>Value of QTIP Trust Assets Not Reduced by Settlement Payment for Undistributed Income</u>. <u>Estate of Kalikow v. Commissioner</u>, T.C. Memo. 2023-21, dealt with an unusual QTIP situation. Pearl B. Kalikow was the beneficiary of a QTIP trust created by her late husband. In 1997, the Trustees of the QTIP (called "SK Trust") created the Kalikow Family Partnership and the trust transferred interests in ten income-producing New York City apartment buildings to KFLP in exchange for a 98.5% limited partnership interest. In 2006, Pearl died when the SK Trust consisted of the KFLP interest and $835,000 in cash and marketable securities. In 2009, one of Pearl's grandchildren petitioned a New York court to compel the Trustee to render an accounting of the SK Trust, claiming that KFLP failed to distribute to the SK Trust its full share of the KFLP distributable amounts, thereby diminishing Pearl's receipt of trust income by $16,946,827. The parties litigated the issue and agreed that the SK Trust would pay Pearl's estate $9,200,000 (which included $6,572,310 in undistributed income from January 1, 2002 through December 31, 2005).

In 2007, Pearl's executors had filed a Form 706 that was made "in respect of all assets of the estate other than Pearl's interest in the [SK] Trust" and listed on Schedule F, Other Miscellaneous Property Not Reportable Under Any Other Schedule, the amount of $31,869,441 which was noted as including "undistributed income due from the SK Trust" in the amount of $4,632,489, along with other claims against the Trustees of the SK Trust. At the same time, Pearl's children filed a separate Form 706, reporting SK Trust assets (including a KFLP value of $42,465,000) and disputing the claim by the executors for the amounts due from the SK Trust.

In a notice of deficiency issued in respect of Pearl's Form 706, the IRS determined that the value of the SK Trust assets was $105,664,857, instead of $42,465,000, and also reduced the estate's Schedule F assets by $4,632,489, the value of the estate's pending claim against the SK Trust.

The estate's petition in Tax Court asserted that it was an error for the IRS to decrease the gross estate value by the $4,632,489 value of the estate's claim against the SK Trust. The limited administrators filed a cross-petition claiming that the value of the SK Trust should be reduced by the amount of any claim allowed for undistributed income due to the estate. The parties then agreed, among other things, that the value of the SK Trust's 98.5% limited partnership interest in KFLP at decedent's death was $54,492,712. The parties then agreed that the only issues to be decided were: (a) the value of the SK Trust assets to be included in Pearl's gross estate and (b) what components of the agreed-upon settlement payment could be deductible by the estate as administration expenses under section 2053, if any.

The Tax Court held that the value of the SK Trust assets included in Pearl's estate should not be reduced by the amount of the settlement payment. The court noted that the executors of Pearl's husband's estate had elected to treat the SK Trust as a QTIP trust. Thus, under section 2044, the SK Trust property was included in Pearl's gross estate at its fair market value at her death, which was $54,492,712, plus the $835,000 in marketable securities. The court noted that, having previously stipulated that the relevant value of the SK Trust's KFLP partnership interest was $54,492,712, the children could not now argue for some lesser value on account of the undistributed income payment liability. Moreover, the liability for the settlement payment does not run to KFLP, so one cannot conclude that this liability would affect the date-of-death fair market value of the SK Trust's KFLP partnership interest. Finally, the court noted that the settlement agreement itself stated that the settlement payment was not expected to be made from the SK Trust's KFLP interest.

The Tax Court also found that the obligation of the SK Trust to make the agreed-upon settlement payment to the estate did not give rise to any deduction under section 2053. The court instead found that the estate's claim against the SK Trust was property that should be included in the gross estate. The court stated that even if it assumed that the estate incurred the fees and commissions noted in the agreed-upon settlement payment, Treas. Reg. § 20.2053-4(d)(3) provides that reimbursement of such expenses under the settlement agreement would preclude any deduction by the estate.

The Second Circuit affirmed. Estate of Kalikow v. Commissioner, 2025 WL 686037 (2nd Cir. 2025). The opinion states:

> Petitioners argue that the Tax Court should have reduced the value of the assets in the SK Trust that are included in Pearl's estate by the Trust's $6,572,310 liability to Pearl's estate. But, Petitioners offer no reason to support their contention that the liability—a putative claim at the time of Pearl's death—affected the fair market value of the SK Trust's assets on the date of Pearl's death.
>
> First, the SK Trust is a separate legal entity that is not itself an asset of the estate. It is an instrument that organized and administered property during Pearl's lifetime and then transferred that property to her heirs. But the Trust itself is not property of the estate; a liability that belongs to the Trust but does not affect the value of the underlying assets would not alter the value of the gross estate.
>
> Second, the terms of the settlement demonstrate that the liability did not affect the fair market value of the assets in the SK Trust. The liability of the SK Trust did not encumber the assets held in the SK Trust. A hypothetical purchaser of the largest asset in the SK Trust—the KFLP partnership—would not accede to the liability and therefore would not regard the liability as affecting the price of the asset. *Cf. Connelly v. United States*, 602 U.S. 257, 260, 264 (2024). Indeed, the parties stipulated that the value of the KFLP partnership interest was $54,492,712, and Petitioners knew of the undistributed income claim at the time they stipulated to that value. Petitioners cannot now "argue for some lesser value of this asset," *Est. of* ***Kalikow***, 2023 WL 2234426, at *7.
>
> ***
>
> In the alternative, Petitioners contend that the Tax Court erred when it denied Petitioners' request for the estate's tax return to include an administration expense deduction pursuant to 26 U.S.C. § 2053(b) for the amount of the settlement payment. We conclude that the Tax Court did not err.
>
> As explained, the entity responsible for paying the undistributed income claim is the SK Trust. By contrast, from the estate's perspective, the claim is owed to the estate to remedy the failure of the trustees to distribute income from the ten properties to Pearl during her lifetime. In other words, the claim is "*property* to be included in the gross estate"—not an expense of the estate. *Est. of* ***Kalikow***, 2023 WL 2234426, at *8 (emphasis added). That conclusion remains even though the liability is borne by an entity that held assets included within the taxable estate.

The taxpayer also tried a common sense argument, that this result will cause double taxation. The argument failed:

> As a last effort to avoid the tax consequences of the settlement, Petitioners argue that the Tax Court's decision will amount to double taxation. They contend that because Pearl's gross estate includes both the settlement for the undistributed income and the underlying assets held in the SK Trust, the same amount is taxed twice. Setting aside whether this assertion has merit, we need not address it because it is entirely theoretical on this record. As Petitioners concede, "an estate tax will not be charged twice." Petitioners' Br. 50–51. That is because only the underlying assets will be taxed as part of the estate. The settlement payment is part of Pearl's residuary estate, which she bequeathed to the Sunshine Foundation. Accordingly, the estate will receive a charitable contribution deduction for the amount of the settlement payment rather than it being taxed at all. *Est. of* ***Kalikow***, 2023 WL 2234426, at *7.

The court's response to this argument is not satisfying.

3. **Decanting QTIP Challenged By IRS**. A docketed Tax Court case, Estate of Lois Horvitz v. Commissioner, (Docket No. 20409-19), involved the decanting of an Ohio QTIP to give the surviving spouse a testamentary power to appoint assets to family foundations. Upon audit, the IRS disallowed the charitable deduction to the estate. The case was settled as noted below. The language of the QTIP was broad:

> In comparison to this common QTIP distribution language, the First QTIP Trusts contain remarkably broad distribution standards that significantly tilt the balance of competing interests in favor of Harry's surviving spouse. Section B. 2.(b) of Article FIRST states that:
>
> > In addition [to the income payments required by I.R.C. 2056(b)(7)], the Trustee may, at any time or from time to time, pay to or apply for the benefit of Lois so much or all of the principal of the Federal Marital Trust as the Trustee, in its sole discretion, deems necessary or desirable for her support, maintenance, health, *comfort or general welfare,* including, without limitation, for any medical emergency.
>
> BSK Decl., Ex. A, Art. FIRST B.2.(b) (emphasis added). The distribution authority is expanded upon in a section entitled "PERMISSIBLE USES AND APPLICATIONS," which provides:
>
> > Any authorization to the Trustee to pay or apply income or principal of any trust to or for the benefit of any beneficiary shall be deemed an authorization to make payments or applications of income or principal for the support, maintenance, health, education, *comfort or general welfare* of the beneficiary *(including, but not limited to,* payments or applications to enable the beneficiary to purchase a residence, invest in a business, make transfers that *serve estate or tax planning objectives,* or engage in *any other activity deemed by the Trustee to be in the best interests* of the beneficiary). An authorization to apply principal to or for the benefit of a beneficiary *shall include authority to pay principal to a trust for the benefit of that beneficiary,* and an authorization to apply income to or for the benefit of a beneficiary (except in cases where the income is required to be distributed currently) shall include authority to

> pay income to a trust for the benefit of that beneficiary and to accumulate income for the separate, exclusive benefit of that beneficiary.

> *Id.,* Art. THIRD B (emphasis added). The trust also specifically provides that the Trustees were not required to limit distributions to Lois even if other resources were available to her. *Id.,* Art. THIRD F. All of these provisions are significantly broader than the language recommended in the sample QTIP forms, and they allowed distributions to Lois under a broad variety of circumstances.

The taxpayer described Ohio law as follows:

> The Ohio Decanting Statute outlines the scope of the decanting authority held by trustees with "absolute power under the terms of the first trust to make distributions of principal to one or more current beneficiaries." Ohio Rev. Code Ann. § 5808.18(A)(1). Subparagraph (A)(2)(b) defines absolute power as "[a] power to make distributions of principal for purposes that *include* best interests, welfare, comfort or happiness, or words of similar import," so long as those words are "not otherwise *limited by reasonably definite standards or ascertainable standards"* (emphases added). Each of these prongs is considered in turn.
>
> As noted above, the Trustees of the First QTIP Trusts clearly had distribution powers that "included" distributions for Lois's comfort and welfare. Moreover, this absolute power was not "limited by reasonably definite standards or ascertainable standards" within the meaning of Ohio law. The Ohio Trust Code contains a definition of an "ascertainable standard" at section 5801.01(b):
>
>> [A] standard relating to an individual's health, education, support, or maintenance within the meaning of section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code.
>
> In other words, Ohio law is entirely consistent with Federal tax law on this point. As noted above on pages 10-11, the Trustees' authority under the First QTIP Trusts to make distributions for Lois's "comfort or general welfare" and in her "best interests" does not constitute an ascertainable standard relating to health, education, support, or maintenance, even when coupled with ascertainable standards. It is therefore an "absolute power" within the meaning of the Ohio Decanting Statute.

The IRS argument is unclear but appears to rest on a distinction between leaving assets to charity and leaving assets to family foundations. In its Opposition to Motion for Partial Summary Judgment, the government argues:

> The Motion is accompanied by Petitioner's Statement of Undisputed Material Facts. Paragraph 17 of that statement avers, "In 2013 Lois updated her estate plan. Lois desired to leave additional assets to charity." Plainly petitioner believes Lois' purported charitable intent to be material to the issue presented in the Motion.
>
> Whether the Modification and Distribution was undertaken to facilitate Lois' purported desire to leave additional assets to charity is a material fact which remains in dispute. Indeed, Michael's January 29, 2013, email[1] to his children suggests that Lois never intended to appoint the trust assets to charity:

> Under the terms of the [1971 QTIP Trusts], after [Lois'] death, whatever is left would go equally to Pam, Peter and me. The problem is that there would be a large estate tax on the amount in that trust before anything went to us. This estate tax could be avoided if instead of going to Pam, Peter and me, the assets of the trusts were to go to charitable foundations controlled by us. Each of us has our own foundations in place, and Pam, Peter, [Lois] and I are all willing to have the trust go to our foundations instead of to us. This would substantially enhance our ability to make charitable contributions and will benefit the family because we would be able to use less of our own resources to make those contributions. So, the plan is to modify these two trusts so that after [Lois] is gone, the assets go to our foundations and not to us.

The implication — that the Modification and Distribution was devised to allow Lois' children to retain control over the trust assets — is contrary to the purported charitable intent avowed in Petitioner's Statement of Undisputed Material Facts. Because there exists a genuine dispute as to a material fact[2] in this case, the Motion is premature and should be denied.

Horvitz was settled on April 6, 2023, with the taxpayer paying $71,830 and receiving a refund of $4,928,170 representing a payment after the notice of deficiency.

4. Invalid QTIP Election. Estate of Martin W. Griffin v. Commissioner**,** T.C. Memo. 2025-47, involved odd facts. First, $2,000,000 went to a QTIP trust but the bequest was not listed as QTIP or marital deduction property on Schedule M. So, there was no marital deduction allowed. The opinion notes:

> The estate contends that the $2 million bequest might still be QTIP because respondent did not mention a problem with the QTIP election (or lack thereof) during the audit process. Because of this supposed shortcoming, the estate invites us to adopt a novel substantial compliance approach and analyze whether the $2 million bequest might qualify as QTIP. The estate's argument is a nonstarter. The Court generally does not look behind a Notice of Deficiency. *Full-Circle Staffing, LLC v. Commissioner*, T.C. Memo. 2018-66, at *25 ("A trial before the Court in a deficiency case is a de novo proceeding; our decision is based on the merits of the record before us and not on any previously developed administrative record."), *aff'd in part, appeal dismissed in part*, 832 F. App'x 854 (5th Cir. 2020). Since no QTIP election was made with respect to the $2 million bequest, that bequest is not QTIP. *See Estate of Higgins v. Commissioner*, 897 F.2d at 859 (denying QTIP treatment for property when an estate did not affirmatively make a QTIP election on the return even though a QTIP election might have been advantageous to the estate).

Then the decedent's Will contained a $300,000 bequest described like this:

> In addition to sub-part (a) above, the Trustee shall distribute the sum of $300,000.00 to the Trustee then serving as the Trustee of the [MCC Trust] (as the Trust may be amended), to be held as a living expense reserve for Maria [C.] Creel, to be distributed to her in the amount of $60,000.00 per year ($5,000.00 monthly) (plus earnings on such amount as determined by Trustee), for up to 60 months from the time of the initial funding of this Bequest. Any undistributed amounts of this Bequest upon Maria C. Creel's death shall be paid to her estate.

The question was whether this amount went into the non-elected QTIP or was held in a separate trust in which case it could be an estate trust. The court held that it was a separate estate trust:

> In Kentucky, the creation of a trust requires that "[1] The settlor has capacity to create a trust; [2] The settlor indicates an intention to create the trust; [3] The trust has a definite beneficiary ...; [4] The trustee has duties to perform; and [5] The same person is not the sole trustee and sole beneficiary." Ky. Rev. Stat. Ann. § 386B.4-020 (West 2018).
>
> The $300,000 bequest clearly met four of the five requirements. Respondent does not dispute that decedent had the capacity to create a trust, or that the bequest has a definite beneficiary (namely Ms. Creel), or that the trustee has clearly laid out duties to perform, or that the trustee and the beneficiary are different persons.
>
> We must decide whether the $300,000 bequest indicates an intention to create a new trust. On the basis of the use of the phrase "living expense reserve" and the specification of distinct distribution provisions that clearly conflict with the existing provisions of the irrevocable MCC Trust agreement, we find that decedent intended to create a trust with the $300,000 bequest and intended for that trust to be administered by the same person administering the MCC Trust. Bolstering this conclusion is the fact that the $300,000 bequest contemplates how any remaining amount will be distributed upon Ms. Creel's death, whereas the $2 million bequest contains no comparable provision. Further, the $2 million bequest does not use the phrase "living expense reserve"—indicating a distinction between these two bequests. Decedent intended for the $2 million bequest to be transferred to the MCC Trust and governed by the provisions of that trust. But he intended for the $300,000 bequest to be a part of a legally distinct trust administered by the same trustee overseeing the MCC Trust.

5. **<u>Blown Portability</u>**. <u>Estate of Billy S. Rowland v. Commissioner</u>, T.C. Memo. 2025-76, deals with a portability return inadequate to the task. Fay Rowland died in April, 2016 with less than the estate tax exemption so her estate filed a portability return. Two years later in January 2019, Billy Rowland died. The IRS claimed and the Tax Court agreed that the portability return was inadequate to allow Billy Rowland to use it. The opinion notes that a portability return must be complete and properly prepared:

> Section 2010(c)(5)(A) provides that a DSUE amount may not be claimed by a surviving spouse unless (1) "the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed," (2) that executor makes an election on the deceased spouse's estate tax return, and (3) such return is timely filed. The parties do not dispute the first two requirements, leaving open only the timeliness of Fay's Return.
>
> Generally, "the due date of an estate tax return required to elect portability is nine months after the decedent's date of death or the last day of the period covered by an extension (if an extension of time for filing has been obtained)." Treas. Reg. § 20.2010-2(a)(1). As relevant here, the IRS offered an additional safe harbor, providing that "a complete and properly prepared" estate tax return would be considered timely if filed "on or before the later of January 2, 2018, or the second annual anniversary of the decedent's date of death." Rev. Proc. 2017-34, § 4.01(1), 4.02, 2017-26 I.R.B. at 1284.

> A return is considered "complete and properly prepared if it is prepared in accordance with [Treasury Regulation] § 20.2010-2(a)(7)." *Id.* § 4.01(1). For its part, Treasury Regulation § 20.2010-2(a)(7)(i) pins the meaning of "complete and properly prepared" to (1) compliance with "the instructions issued for the estate tax return (Instructions for Form 706)" and (2) satisfaction of "the requirements of [Treasury Regulation] §§ 20.6018-2, 20.6018-3, and 20.6018-4." Both parties focus on the former requirement.

What triggered up the Fay Rowland estate was the meaning and effect of the special rule for marital and charitable deduction property:

> Treasury Regulation § 20.2010-2(a)(7)(ii) establishes a "special rule" for marital or charitable deduction property where the estate is not required to file a return under section 6018(a). In such a case, the executor is not required to report the value of such property but "only the description, ownership, and/or beneficiary of such property, along with all other information necessary to establish the right of the estate to the deduction." *Id.* In essence, Treasury Regulation § 20.2010-2(a)(7)(ii) relaxes the reporting requirements governing valuation of property that will ultimately be deducted from the value of the gross estate by means of sections 2055 and 2056 in the case of a return being filed solely to elect portability.
>
> ***5** What the Treasury Regulations give, however, they take away in four specified circumstances. As relevant here, relaxed reporting does not apply to marital or charitable deduction property if "[t]he value of such property relates to, affects, or is needed to determine, the value passing from the decedent to a recipient other than the recipient of the marital or charitable deduction property." Treas. Reg. § 20.2010-2(a)(7)(ii)(A)(*1*).
>
> Treasury Regulation § 20.2010-2(a)(7)(ii)(C), example 3, shows the mechanics. This example posits a hypothetical will "provid[ing] that 50 percent of the property passing under the terms of H's will is to be paid to a marital trust for W and 50 percent is to be paid to a trust for W and their descendants." *Id.* The example concludes that the general return requirements apply because the "amount passing to the non-marital trust cannot be verified without knowledge of the full value of the property passing under the will." *Id.* "Therefore, the value of the property of the marital trust relates to or affects the value passing to the trust for W and the descendants of H and W." *Id.*

Fay Rowland's estate plan left 20% of her estate to a family foundation, because that meant <u>values</u> were important. The opinion states:

> 1. *Section 2010(c)(5)(A)*
>
> Fay's Return failed to make a proper portability election under section 2010(c)(5)(A). According to that provision, "[n]o election may be made ... if [the relevant] return is filed after the time prescribed by law (including extensions) for filing such return." *See also* Treas. Reg. § 20.2010-2(a)(1) ("[T]he due date of an estate tax return required to elect portability is nine months after the decedent's date of death or the last day of the period covered by an extension (if an extension of time for filing has been obtained)."). In this case, Mrs. Rowland died on April 8, 2016, and it is undisputed that her executor did not file Fay's Return by the extended deadline of July 8, 2017. Thus, Fay's Return was ineligible for the election under section 2010(c)(5)(A).

2. *Rev. Proc. 2017-34*

Fay's Return likewise does not qualify for the safe harbor embodied in Rev. Proc. 2017-34. As an initial matter, the filing of Fay's Return on January 2, 2018, complies with the requirement that the return be filed “on or before the later of January 2, 2018, or the second annual anniversary of the decedent's date of death.” *See* Rev. Proc. 2017-34, § 4.01(1).

Although Fay's Return clears the first hurdle for relief, it crashes into the next, i.e., a “complete and properly prepared” return prepared in accordance with Treasury Regulation § 20.2010-2(a)(7). *See* Rev. [*9] Proc. 2017-34, § 4.01(1). Fay's Return did not provide valuation information regarding each of the interests in property reported on the various schedules. These omissions contravene the Form 706 instructions, which Treasury Regulation § 20.2010-2(a)(7)(i) treats as necessary for a complete and properly prepared return.

Nor can Fay's Return shelter under the special rule set forth in Treasury Regulation § 20.2010-2(a)(7)(ii). This rule relaxes valuation reporting requirements, but with respect to only marital and charitable deduction property. *Id.* At best, it would allow Fay's Estate to estimate the value of only certain assets and does not obviate the need to comply with the detailed reporting requirements for assets that did not pass to either Mr. Rowland or charity.

Fay's Return makes no attempt to identify and distinguish marital and charitable deduction property and instead incorrectly applies the relaxed treatment across the board. Specifically, it reports (on Part 5 — Recapitulation) a value of “$0” for each category of property listed on the various schedules and a total value of $3 million on the entry for “Estimated value of assets subject to the special rule of Reg. section 20.20210-2T(a)(7)(ii).” The relevant instruction confirms that such treatment is reserved only for “the estimated value of the *assets subject to the special rule*,” i.e., marital and charitable deduction property. (Emphasis added.) As Fay's Estate plainly contains property that did not pass to Mr. Rowland or charity, Fay's Return failed to satisfy the applicable regulation (and instructions) as to the nonmarital and charitable deduction property. It thus was not complete and properly prepared.

*6 Fay's Return also erred in applying the relaxed reporting requirements to the marital and charitable deduction property of Fay's Estate. The loosened reporting standard “does not apply” where the “value of such property relates to, affects, or is needed to determine, the value passing from the decedent to a recipient other than the recipient of the marital or charitable deduction property.” Treas. Reg. § 20.2010-2(a)(7)(ii)(A)(*1*). The Trust Agreement provides for a distribution of 20% of the trust estate to a charitable family foundation and “such amount ... as when added to property to [Mr. Rowland] under my Last Will and Testament ... will be equal to one-fourth of my gross estate,” defined to mean “all property included in my gross estate for federal estate tax purposes.” The Trust Agreement further states that the residue of the trust would be distributed to trusts for various grandchildren. Plainly, the value of the property passing to the family charitable foundation and [*10] Mr. Rowland “relates to, affects, or is needed to determine” the value passing to the trusts for Mrs. Rowland's grandchildren. Relaxed reporting does not apply.

In summary, Fay's Return was not entitled to estimate the gross value of Fay's Estate but instead was required to provide specific valuation information for each property interest listed in the schedules. Fay's Return thus did not constitute a

> complete and properly prepared return eligible for the Rev. Proc. 2017-34 safe harbor.

The Court did not apply a substantial compliance standard because it didn't find that the estate did.

> We need not resolve here, however, whether the doctrine of substantial compliance is ever available for making a valid DSUE election.[6] Even assuming arguendo that the doctrine of substantial compliance is available, Fay's Return did not measure up under that doctrine. Generally, the doctrine of substantial compliance is designed to avoid hardship in cases where a taxpayer does all that is reasonably possible, but nonetheless fails to comply with the specific requirements of a provision. *See, e.g.*, *Samueli v. Commissioner*, 132 T.C. 336, 345 (2009).
>
> We are unconvinced that Fay's Return can be seen as doing all that was reasonably possible to comply with Treasury Regulation § 20.2010-2(a)(7). This regulation requires a return making a DSUE election to satisfy the requirements of the Form 706 instructions. Treas. Reg. § 20.2010-2(a)(7)(i). These instructions, in turn, direct an estate to list items of property by schedule and provide a fair market value of each item of property according to methodology provided in the instructions. The rigors of this reporting regime are only relaxed for marital and charitable deduction property (which would not be part of the taxable estate) and only where such property would not "relate[ ] to, affect[ ], or [be] needed to determine, the value" of nonmarital or charitable deduction property. Treas. Reg. § 20.2010-2(a)(7)(ii)(A)(*1*).
>
> These reporting requirements came in direct response to Congress's command that the IRS "shall prescribe such regulations as may be necessary or appropriate to carry out" the various aspects of the unified credit regime, including the DSUE. I.R.C. § 2010(c)(6). Specific to the DSUE context, Congress authorizes the IRS to "examine a return of the deceased spouse to make determinations with respect to such amount for purposes of carrying out this subsection," notwithstanding any normal limitation periods. I.R.C. § 2010(c)(5)(B). And Congress expressly forbids the claiming of the DSUE amount outside of an election on a timely filed return. I.R.C. § 2010(c)(5)(A). In short, Congress set up a regime to allow the IRS to obtain information on the required return to evaluate the DSUE amount claimed and identify problematic elections.
>
> ***8** Fay's Return falls well short of providing the requisite information. Although Fay's Return lists various items of property by schedule, it does not include the fair market value at the date of death of any such item. In computing the DSUE amount, Fay's Return instead estimates the gross value of Fay's Estate as $3 million and includes the amounts of specific bequests to various individuals. Fay's Return thus **[*13]** provides a fraction of the detailed item-by-item value reporting required to support the claimed gross estate and DSUE amount.
>
> Nor do we view the errors and omissions on Fay's Return as a mere foot-fault. Fay's Return does not allow the IRS to do the work entrusted to it by a Congress that expected the IRS to police DSUE elections. As implemented in the instructions, Treasury Regulation § 20.2010-2(a)(7) requires the provision of specific valuation information so that the IRS can verify the DSUE amount or examine further. Fay's Return obscures, rather than illumines, the property-specific information needed to verify the DSUE amount and thus frustrates the IRS's efficient identification of questionable DSUE elections. And the fact that the IRS might be able to use the specific bequests on Fay's Return together with

> the Trust Agreement to somehow reverse engineer the DSUE amount does not stand in for the required information missing from the face of the return. We accordingly conclude that the failure to report the requisite property value information on Fay's Return cannot be excused on substantial compliance grounds.

Footnote 6 reads:

> To be clear, the applicability of the doctrine of substantial compliance generally would require us to determine that the reporting requirements enshrined in Treasury Regulation § 20.2010-2(a)(7) did not relate to the substance or essence of the statute. *See Bond v. Commissioner*, 100 T.C. 32, 41 (1993); *see also Estate of Chamberlain v. Commissioner*, T.C. Memo. 1999-181, 1999 WL 349350, at *12 ("[T]here is no defense of substantial compliance for failure to comply with the essential requirements of the governing statute [or] ... if to [apply substantial compliance] would defeat the policies of the underlying statutory provisions."), *aff'd*, 9 F. App'x 713 (9th Cir. 2001). Given our conclusion that Fay's Return did not substantially comply with the governing requirements, we need not (and accordingly will not) resolve this issue. *See, e.g.*, *Stromme v. Commissioner*, 138 T.C. 213, 218 n.8 (2012) ("For now, the better course is 'to observe the wise limitations on our function and to confine ourselves to deciding only what is necessary to the disposition of the immediate case.' " (quoting *Whitehouse v. Ill. Cent. R.R. Co.*, 349 U.S. 366, 372–73 (1955))); *see also, e.g.*, *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 799 (D.C. Cir. 2004) (Roberts, J., concurring in part and concurring in the judgment) (explaining that where "a sufficient ground [exists] for deciding [a] case, ... the cardinal principle of judicial restraint—if it is not necessary to decide more, it is necessary not to decide more—counsels us to go no further").

N. SECTIONS 2501 TO 2524 – GIFTS

1. Addition of Tax Reimbursement Clause In A Grantor Trust Is A Gift By Someone Of Some Amount. CCA 202352018. While the grantor of a grantor trust is living, the income of the grantor trust is taxed to the grantor. Typically, the grantor of the trust is not a beneficiary so the grantor pays income tax on income she does not actually receive. From a transfer tax point of view this is desirable because the trust receives, in effect, an income tax free rate of return (akin to that of an IRA or retirement plan) and the payment of the additional income tax reduces the grantor's taxable estate for estate tax purposes.

Suppose, however, that the grantor either lacks sufficient income to pay the extra income tax attributable to the grantor trust income or simply does not want to pay the extra income tax. One solution would be to give up the powers that make the trust a grantor trust but in some situations that is impossible under the trust instrument or undesirable for other reasons. For example, consider a large asset that was sold to a grantor trust for a note. If the asset will be or was sold, but it is desirable to leave the note in place, the income on the sale may be substantial without the grantor having the means to pay it. Another potentially problematic situation could be where a grantor has transferred significant assets through fine estate planning and desires to retain her remaining assets for a charitable gift at her death. Payment of income taxes may at some point become contrary to the grantor's desired estate plan.

Rev. Rul. 2004-64 provides that a grantor's payment of income taxes on a grantor trust is not a gift. The stated rationale is that paying the income taxes is the grantor's legal obligation and fulfilling a legal obligation cannot be a gift. That conclusion was not inevitable. In most instances, a grantor trust is created by the grantor deliberately. If a grantor made a gift to Trust 1, which is not a grantor trust, and on the same day made an identical gift to Trust 2 which is a grantor trust, the beneficiaries of Trust 2 are better off – have received more – than the beneficiaries of Trust 1. Why wouldn't the gift to Trust 2 be more than Trust 1? One reason would be because it is uncertain; perhaps the grantor dies the day after the trust is funded, or goes bankrupt, or there is no trust income. Accordingly, we could imagine the IRS saying that the initial gifts to Trust 1 and Trust 2 are equal, but the subsequent payment of income tax is an additional gift by the grantor. However, that is not the position the government took in Rev. Rul. 2004-64. A parallel may be found in the equivalent treatment of gifts of high basis and low basis assets: a gift to Fred of $1000 of zero basis assets and a gift to Myrtle of $1000 of cash, a high basis asset, are each gifts of $1000. In fact, presumably if a donor promised to pay Fred's income taxes that would be an additional gift because the donor has no legal obligation to do so.

If a grantor is concerned about paying income tax on income not received, the grantor may design the grantor trust with a power in the trustee to make distributions to the grantor to pay income taxes. Is that a retained interest for section 2036 purposes? Rev. Rul. 2004-64 deals with both situations. If the trustee must reimburse the grantor for income taxes, then that retained power is one described under section 2036(a)(1). However, if an independent trustee has a discretionary right to reimburse the grantor, that alone will not trigger section 2036, although in conjunction with other facts (a real or understood agreement between the grantor and the trustee regarding reimbursement, for instance, or if applicable state law provided that such a provision would subject the assets to the grantor's creditors).

In some states, a statute gives the trustee authority to reimburse a grantor for income taxes attributable to income from a grantor trust. Seven states have such statutes: New York, New Hampshire, Colorado, Delaware, Connecticut, Florida, and Indiana. See generally Curatolo and Smith, "Strategies for Mitigating the 'Burn' of Grantor Trust Status," 48 Tax Mgmt. Est., Gifts & Tr. J. No. 3 (May 11, 2023) (Indiana is a more recent addition to the list).

Rev. Rul. 2004-64 dealt with one additional issue: would the actual beneficiaries of the trust be making a gift if the trustee reimbursed the donor pursuant to the trustee's discretionary power? The Ruling states, "[f]urther, the $2.5X paid to A from Trust as reimbursement for A's income tax payment was distributed pursuant to the exercise of the trustee's discretionary authority granted under the terms of the trust instrument. Accordingly, this payment is not a gift by the trust beneficiaries to A." The Ruling does not describe the discretionary power but the Ruling's conclusion seems overly broad. Presumably the beneficiaries do not make a gift if they could not successful challenge a trustee's reimbursement for income taxes but a mere discretionary power would not mean in all circumstances the power could be exercised. For instance, consider a grantor with vast amounts of income, most of which is regularly accumulated by the grantor, and a grantor trust with an tiny amount of income; is it really true that the beneficiaries would never be successful with a claim that the trustee's discretion would not allow a reimbursement? Be that as it may, the government is clearly not concerned about the gift implications.

Consider a grantor trust that does not give the trustee a right to reimburse, in a state without an authorizing statute. May a subsequent amendment of the trust by non-judicial settlement agreement or through a decanting add such a power. Under what has become "normal" state law in most jurisdictions the answer would be yes. PLR 201647001 concluded that such a modification would be "administrative" in nature and would not change the beneficial interests in the trust.

On December 29, 2023, in CCA 202352018 the IRS National Office announced that PLR 201647001 no longer reflected the position of the Chief Counsel's Office. Instead, the CCA determined that a modification to add a tax reimbursement clause will constitute a taxable gift by the beneficiaries of the grantor trust because the ability of a trustee to distribute income and principal to the grantor "is a relinquishment of a portion of the beneficiaries' interest in the trust." Under the facts of the CCA, the modification is made by a petition in state court which is consented to by the grantor's child and future descendants (the child has no current living grandchildren or other descendants). Accordingly, says the CCA, each of the child and the child's issue (none at the moment) have made a gift "of a portion of their respective interest in income and/or principal." What's the value of the gift? The CCA notes that the determination of the values of the gifts requires "complex calculations" (footnote 2) but that complexity does not defeat the gift tax.

The CCA cites to Treas. Reg. § 25.2511-1(e) and § 25.2511-2(b) to support the existence of the gift. Do either of those help us with the "complex calculations?" The latter provision states:

> (b) As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. For example, if a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift. On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift. However, if the exercise of the trustee's power in favor of the grantor is limited by a fixed or ascertainable standard (see paragraph (g)(2) of section 25.2511-1), enforceable by or on behalf of the grantor, then the gift is incomplete to the extent of the ascertainable value of any rights thus retained by the grantor

Presumably this does not mean that the gift, of whatever amount, by the beneficiaries is incomplete even though it is perfectly clear that the beneficiaries could receive all the trust assets at the discretion of the trustee. If, however, the trust had given one or more beneficiaries nongeneral powers of appointment, then perhaps the gift would have been incomplete, until a reimbursement distribution was actually made. Does that suggest that prior to the addition of the reimbursement right the trust should have been amended to add a power of appointment? Would that addition itself have been a gift in the eyes of the National Office? Suppose the trust had been amended to provide that during the grantor's lifetime the trustee's distribution power was limited by an ascertainable standard; § 25.2511-2(b) states that the gift by the donor – and remember that the donors here are the beneficiaries – is incomplete to the extent of any rights ascertainably retained, so in that instance the gift must be less than it would be if the trustee continue to have full discretion although how much less we cannot determine.

Treas. Reg. § 25.2511-1(e) states:

> (e) If a donor transfers by gift less than his entire interest in property, the gift tax is applicable to the interest transferred. The tax is applicable, for example, to the transfer of an undivided half interest in property, or to the transfer of a life estate when the grantor retains the remainder interest, or vice versa. However, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift. Thus if a donor, aged 65 years, transfers a life estate in property to A, aged 25 years, with remainder to A's issue, or in default of issue, with reversion to the donor, the gift tax will normally be applicable to the entire value of the property.

This section bears close analysis. The first sentence notes that if a donor – again, a beneficiary – transfers less than his entire interest, the gift is of the interest transferred. Here, a beneficiary has a discretionary interest in the trust and thus it seems difficult for a beneficiary to make a gift in excess of the value of that interest. All the beneficiaries may have a collective interest equal to the entire value of the trust, if you include all unborn, unascertainable, and remote beneficiaries, but gifts are normally calculated on a donee by done basis.

The second sentence advances the ball not at all, so we move to the third sentence which provides that if a donor's retained interest is "not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift." Here the right retained by a beneficiary is a discretionary interest which ordinarily would not be susceptible of valuation (although under certain circumstances the value might be zero: for instance, consider whether a trustee would make a distribution to a very wealthy, incapacitated, terminally ill beneficiary whose heirs were different from the trust beneficiaries; or 100%, as could be the case if the trust were very small and the eldest beneficiary, who had never before received a distribution, was terminally ill, poor, and wanted the trustee to fly in the beneficiary's birth parent whom the beneficiary had only just discovered so that they could meet, albeit briefly, before the beneficiary died). Thus, under ordinary circumstances, the value of a beneficiary's gift would be equal to the entire value of the gift. Does that mean the total gift by all the beneficiaries, or the gift by the beneficiary in question? As noted above, normally gift tax is determined on a beneficiary by beneficiary basis, and thus it would appear we look to the beneficiary's interest in the trust – the unascertainable, discretionary interest. A "complex calculation" indeed. Presumably if the authors of the CCA had intended the gift to be of the entire gift of all the beneficiaries it would have said so, and in fact the "complex calculation" would have been simple: the value of the entire trust property.

Section 2702 provides that where a transferor – here a beneficiary – transfers an interest in a trust to or for the benefit of a member of the transferor's family (the transferor's spouse, an ancestor or lineal descendant of the transferor or the transferor's spouse, any brother or sister of the transferor or the transferor's spouse, and the spouse of any ancestor, descendant, or sibling of the transferor) that transfer is a gift and any interest retained by an applicable family member (transferor's spouse, ancestor of the transferor or spouse, and spouse of any ancestor) is valued at zero. Here, if the grantor is an ancestor of a beneficiary, which would be true in the typical case, the beneficiary has made a gift of the beneficiary's interest in the trust and the value of any retained interests by applicable family members would be zero. Let's suppose that value of the retained interests would be zero which would be true in the typical case; we are still left with the "complex calculation" of the value of the beneficiary's discretionary interest in the trust. Once again, may we assume that if the authors of the CCA had thought section 2702 meant that the value of the gift equaled the entire value of the trust property they would have said so (and avoided any "complex calculation" entirely).

We are left with at least two uncertainties. One is that we do not know what the value is of the gift a beneficiary made. We have no experience, and apparently neither does the National Office, valuing discretionary interests in trusts. The other is that we do not know if this ruling represents an isolated situation or will be seen in future years as the vanguard of a broad effort to characterize all sorts of trust modifications as gifts.

If a grantor trust needs to be modified, what steps may be taken to limit the damage? One consideration may be the number of living beneficiaries; the more beneficiaries, the more difficult it would appear to be for the government to pin a gift on just a few, and the division among all may significantly reduce the tax effect of the gift. Consider a $100 million capital gain, with $25 million in tax to be reimbursed, in a trust with three children and seven grandchildren – 10 beneficiaries to share a $25 million gift. That is certainly not ideal, but it often will not completely undo the family's estate plan. Another consideration is whether the beneficiaries are better off arguing that each of their gifts must be minimal, because their trust interests are indeterminate, or capping the maximum amount of the gift. The latter could be done in a several ways; for example, suppose in the example above the $25 million were segregated into a separate trust share and then the beneficiaries amended the trust to allow the reimbursement from only that share. The maximum gift would seem to be $25 million in such instance. Such a strategy would seem worthwhile only if the beneficiary(ies) were worried about the application of a theory that would cause the gift to be of the entire value of the trust.

Consideration should also be given to other strategies that would allow the grantor to pay her income tax without an actual distribution from the grantor trust. For example, what if a loan were made to the grantor. That may be unacceptable because it ultimately costs the grantor's estate the amount of the reimbursement, an amount the grantor had intended to go elsewhere. If elsewhere is to a charitable beneficiary then the problem may be finessed by ensuring that either the trust or the beneficiaries distribute assets to the charitable beneficiary at the grantor's death.

If a grantor may turn off grantor trust status, a bargain may be reached between the trustee and the grantor. The trustee determines that it should reimburse the grantor only if the grantor agrees not to give up the provisions that cause the trust to be a grantor trust. In the typical case, the grantor's agreement will have significant value. The grantor paying the income tax on the grantor trust income is not a gift; might the agreement to continue doing so be a gift? The answer should be no. The payment from the trust to the grantor should not be subject to income tax because the trust is a grantor trust (as opposed to a payment from the beneficiaries to the grantor). Is the value of the grantor's agreement consideration which is subtracted in valuing the gift made by the beneficiaries?

Returning to the CCA, it does not distinguish between a nonjudicial settlement agreement or a decanting, at least a decanting which is "pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise their right to object." Presumably where a beneficiary does object and the court ignores the objection the beneficiary has not made a gift. That leaves many questions unanswered. For instance, suppose the trustee moves the situs of the trust to a jurisdiction that allows reimbursement. Or, suppose the trustee distributes all of the assets from grantor Trust 1, which has no right of reimbursement for the grantor, to grantor Trust 2, which has a right of reimbursement, and notifies the beneficiaries. The grantor notifies the beneficiaries as well, of how pleased she is with this development because otherwise she was seriously considering turning off grantor trust status (and perhaps modifying her estate plan). Put more simply, is the CCA making a real point here or is it all just theater?

From a planning point of view, even if experience indicates that a grantor rarely needs or wants reimbursement given the myriad of ways the grantor can access cash in the trust, perhaps there is no downside to including a right of reimbursement in a grantor trust as a matter of routine. If the IRS is going to complain about addition of the power later then inclusion at the outset provides flexibility whether or not the trustee uses the authority.

2. Gifts vs. Loans vs. Loans Incapable of Repayment. At issue in Estate of Bolles, T.C. Memo. 2020-71, was whether various transfers, mother to son, were gifts, loans, or, as it turns out, loans that couldn't be repaid. The case suggests that taxpayers should argue with the IRS if they can prove a change in circumstances between the time of an unpaid loan and the time of the lender's death. The court's conclusion is as follows:

> Finally, we address the issue of whether the advances were loans or gifts. Both parties rely on the analysis of Miller v. Commissioner, T.C. Memo. 1996-3, aff'd, 113 F.3d 1241 (9th Cir. 1997), for the traditional factors used to decide whether an advance is a loan or a gift. Those factors are explained as follows: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.
>
> These factors are not exclusive. See, e.g., Estate of Maxwell v. Commissioner, 98 T.C. 594 (1992), aff'd, 3 F.3d 591 (2d Cir. 1993). In the case of a family loan, it is a longstanding principle that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the tax characterization of the transaction as a loan. Estate of Van Anda v. Commissioner, 12 T.C. 1158, 1162 (1949), aff'd per curiam, 192 F.2d 391 (2d Cir. 1951).

> While Mary recorded the advances to Peter as loans and kept track of interest, there were no loan agreements or attempts to force repayment. Respondent focuses on the lack of security for the loans to Peter. We agree that the reasonable possibility of repayment is an objective measure of Mary's intent. The estate maintains that during her life Mary always considered these advances as loans. We cannot reconcile this argument with the deterioration of Peter's financial situation and the ultimate failure of his practice in San Francisco and later in Las Vegas.
>
> Peter's creativity as an architect and his ability to attract clients likely impressed Mary. We find she expected him to make a success of the practice as his father had, and she was slow to lose that expectation. However, it is clear she realized he was very unlikely to repay her loans by October 27, 1989, when her trust provided for a specific block of Peter's receipt of assets at the time of her death. Accordingly, in 1990 the "loans" lost that characterization for tax purposes and became advances on Peter's inheritance from Mary. In conclusion, we find the advances to Peter were loans through 1989 but after that were gifts. We have considered whether she forgave any of the prior loans in 1989, but we find that she did not forgive the loans but rather accepted they could not be repaid on the basis of Peter's financial distress.

For the opinion to be helpful requires close attention to the facts:

> A loving mother of her five children, Mary was determined to provide her assets to her children equally. Her practice was to keep a personal record of her advances and occasional repayments for each child. On the basis of her original intent and the advice of her tax counsel, she treated the advances as loans. She forgave the "debt" account of each child every year on the basis of the gift tax exemption amount. Her practice would have been noncontroversial but for the substantial funds she advanced to Peter.
>
> ***
>
> Peter was the oldest of their five children. He graduated from college with a degree in architecture in 1965. On the basis of his academic achievements and his father's reputation as an architect in San Francisco, Peter's professional career showed great promise. He began his career in Boston. He took over his father's architecture practice in San Francisco in the early 1970s and enjoyed some early success in attracting clients. Peter expanded the practice through the 1970s into the early 1980s; but despite his salesmanship he began to have financial difficulties largely because his expectations exceeded realistic results. By 1983 Peter's practice was not current on its bills. In July 1983 Peter, as president of Bolles Associates and Peter B. Bolles, P.A., entered into an agreement with the Bolles Trust to use trust property as security for $600,000 in bank loans. The agreement also reflects that the Bolles Trust was owed $159,828 in back rent by Peter's practice. Within a year Peter had failed to meet the obligations of the agreement, and the Trust was ultimately held liable for the $600,000. Mary had contemporaneous knowledge of these events.

Between 1985 and 2007 Mary transferred $1,063,333 to or for Peter's benefit (directly to him, to his accounts, paying other of his debts). Peter made no payments after 1988. In Mary's estate plan, she adjusted for the transfers, with interest (using the AFR). The IRS argument was that either Mary made gifts or a note should be in her estate:

> The calculations found in article five of the First Amendment describe the manner in which advances, described as loans, are to be taken into account in dividing the trust assets among decedent's children upon her death. In essence, under subparagraph (b), the value of the trust assets after allowance for expenses such as estate tax is divided equally; however, each child's share is reduced, and that amount redistributed pro rata among the other beneficiaries, by the amount of the child's outstanding loans, if any, plus accrued interest.
>
> The explanation of adjustments to the notice of deficiency states:
>
> I. Schedule C, Items 2 and 3:
>
> It is determined that the fair market value of the Promissory Note and receivable due from Peter P. Bolles under IRC section 2031 is $1,063,333 instead of zero as reported and that interest on the Promissory Note and receivable is includible in the gross estate under IRC section 2033 in the amount of $1,165,778. Therefore, the value of the gross estate is increased by $2,229,111.
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> II. Adjusted Taxable Gifts
>
> In the event it is determined that the fair market value under IRC section 2031 of the Promissory Note and receivable from Peter Bolles and interest on the Promissory Note and receivables is zero then it is determined that Mary P. Bolles transferred property to Peter Bolles during her life such that "adjusted taxable gifts" in the amount of $1,063,333 is included in computing taxpayer's estate tax liability under IRC section 2001(b).

This is an interesting situation but one that is difficult but not impossible to replicate for planning purposes. Suppose a parent loans money to a child to pay the child's expenses during, say medical school; then the child goes into a line of medical work that cannot support repayment. Perhaps in such instance a no gift, no loan position could be sustained, but most families would not plan for such.

The Ninth Circuit upheld the Tax Court without much comment. Estate of Bolles v. Commissioner, 2024WL1364177 (9th Cir.). The Court did reject an estate argument that the decedent's revocable trust should not be liable for gift tax:

> The Estate claims that Mary's personal trust has no tax-reporting or payment responsibilities with respect to the payments from Mary to Peter that are classified as gifts, since the gifts were made by Mary, not the trust. We disagree. A foundational principle in estate law is that a decedent's liabilities become part of her estate after death. *See* George G. Bogert, *The Law of Trusts and Trustees* 2 § 12 (2024) (noting that the executor pays the decedent's debts out of the estate). Indeed, estate tax is imposed not on the decedent herself, but on the transfer of her taxable estate. 26 U.S.C. § 2001(a); *see also id.* § 2002 (noting that the estate tax "shall be paid by the executor [of the *estate*]") (emphasis added). Mary's trust is not a separate taxpayer from Mary for purposes of the estate tax.

3. **Effect of AFR Interest Rate On Loan Value**. In Estate of Barbara Galli v. Commissioner, No. 7003-20 (T.C. 2025), Judge Holmes considered a situation where the IRS objected to the bona fides of a loan where mom loaned money to son at the AFR. The opinion notes:

Key Facts: The decedent lent $2.3 million to her only child on February 25, 2013, at which time she was 79 years of age. The *terms of the loan were set forth in a note that provided for a 9 year term* and interest at an alleged applicable federal rate of 1.01%. The note provided for annual payments of interest, with repayment of the principal due at the end of the term: The loan was unsecured and *the note lacked provisions necessary to create a legally enforceable right to repayment reasonably comparable to the loans made between unrelated persons in the commercial marketplace. It has not been shown that the borrower had the ability or intent to repay the loan. It has not been shown that the decedent had the intent to create a legally enforceable loan, or that she expected repayment*. The decedent did not file a gift tax return relating to the loan. *The borrower made annual payments of interest* as required during February of 2014, 2015 and 2016. On March 7, 2016, the decedent died, leaving a taxable estate that included the loan repayment obligation reflected by the note. Under the estate plan, the borrower inherited the note. For estate tax purposes, the estate valued the note at $1,624,000. The difference between the amount lent and the fair market value of the note then determined by the IRS is $869,000.

Primary Determination: *The amount by which the value of money lent in 2013 exceeds the fair market value of the right to repayment set forth in the note is a previously unreported and untaxed gift*. The fair market value of future payments to be made under the note when the loan was made is determined by the IRS appraisal. See I.R.C. section 2512 and the regulations thereunder. In the absence of significant risk that the amount lent will not be repaid, discounting the present value of future payments only to reflect the time value of money can be appropriate. See Frazee v. Comm'r, 98 T.C. 554 (1992). In contrast, where significant repayment risk is present, the present fair market value of future payments must take into account the risk of non-payment, in addition to any discount required to reflect the time value of money. See, e.g., Dallas v. Commissioner, T.C. Memo. 2006-212, (discounting the value of self-canceling installment notes in the bargain sale context to reflect risk of non-payment). Here, the estate reported the value of the note at a value that discounts the future payments due under the note in an amount which reflects risk of non-payment, over and above time value of money considerations. The principles of asset valuation are to be applied consistently for gift tax and estate tax purposes, consistent with the doctrine of in pari materia. In addition, the duty of consistency precludes the estate from maintaining inconsistent valuation approaches for gift and estate tax in order to avoid gift tax on a transaction designed to reduce estate tax. Accordingly, *there is a previously unreported and untaxed gift, in the amount of $869,000, subject to estate tax*.

Alternative Determination: For purposes of determining the value of the gross estate, the value of the note must be determined by discounting the value of future payments to reflect time value of money considerations only, by applying the applicable federal rate. This approach mirrors the reporting position of the decedent when the decedent did not report gift tax with respect to the loan in 2013. Under the alternative determination, the value of the gross estate for estate tax purposes is increased by $544,000.

The court held for the taxpayer, with helpful language about notes and section 7872:

> That's what we think happened here. Respondent submitted only one item of proof — a declaration in support of the uncontested fact that Barbara Galli did not file

a gift-tax return to report this transaction with her son. Stephen, by contrast, submitted a copy of his mom's bank record showing a transfer of $2.3 million, the note they both signed, his own bank records that show he paid interest to his mom each year, and even his mom's income-tax returns that show she reported it as interest income.

One has to recognize that the characterization of a transfer of money as a loan has created a multiprong test. *See*, *e.g.*, *Miller v. Commissioner*, 71 T.C.M. (CCH) 1674, 1679 (1996) (citing *Estate of Maxwell v. Commissioner*, 98 T.C. 594, 604-05 (1992). But we don't have to dance among these prongs — much as in *King v. Commissioner*, 87 T.C. 1213, 1216-17 (1986), which was a fight about the almost always fact-bound issue of whether a transaction was a sham — prongification does not make summary judgment impossible. In King we granted summary judgment to a taxpayer who supported his position with an affidavit that "detailed information concerning his background, his CME and IMM trading activities, and his trading strategies, as well as general information on the trading of gold futures contracts by the use of straddles." The Commissioner, by contrast, "failed to allege any facts to support his general allegation of sham."

The answer to our first question then is that the Commissioner hasn't made recharacterization of the entire transaction as a gift an issue in this case and, even if he had, did not support his opposition with adequate proof.

2. What's the Effect of Section 7872?

This leaves us with the second and much easier part of petitioner's motion. He argues that section 7872 governs the field of loans with below-market interest rates. Because his mom's loan to him charged the applicable federal rate it is, to use the jargon of the Code, not a "below-market loan to which section applies." See IRC §7872(c). That might leave open the question of whether to recharacterize a loan as a partial gift if it carries an interest rate below market but equal to or above the applicable federal rate. But we rejected this argument many years ago in *Frazee v. Commissioner*, 98 T.C. 554, 588 (1992), where we held that "[t]he coverage of section 7872 clearly goes beyond *Dickman*[2] to provide comprehensive treatment of below-market loans for income and gift tax purposes."

We reiterated the point later in that opinion by concluding that "Congress indicated that virtually all gift transactions involving the transfer of money or property would be valued using the current applicable Federal rate. . . . Congress displaced the traditional fair market methodology of valuation of below-market loans by substituting a discounting methodology." *Id*. at 589.

To sum up, the issue on these motions are whether the transaction was a gift, a loan, or a partial gift. We determine that the Commissioner is not asserting that the transaction was entirely a gift and would lose on the proof if he were. That leaves us to apply section 7872, and under that section, this transaction was not a gift at all.

4. **Corporate Reorganization**. Under review in PLR 202406001 were the gift tax consequences of a corporate reorganization. The facts involved a company with three classes of stock owned by multiple shareholders, including GRATs. Nonetheless, the movement of value was straightforward as the ruling notes:

Company is owned by Executive, Trusts, and Non-Contributing Shareholders. In Agreement, Executive and Trusts agree to surrender shares to Company in order to fund LLC. By entering into Agreement, Executive and Trusts are increasing the value of the shares held by the Non-Contributing Shareholders. For gift tax purposes, this transfer is characterized as an indirect transfer of property from Executive and Trusts to Non-Contributing Shareholders. See §§ 25.2511-1(c)(1) and 25.2511-1(h). *See also* Rev. Rul. 71-443, 1971 C.B. 337; *Bosca v. Commissioner*, T.C. Memo. 1998-251; *Kincaid v. United States*, 682 F.2d 1220 (5thCir. 1982); *Estate of Trenchard*, T.C. Memo. 1995-121.

The transactions fit within the ordinary course of business gift tax exceptions:

> Under § 25.2512-8, a transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for adequate and full consideration in money or money's worth. Under the facts presented in this ruling, the transfer made through Agreement satisfies all three of the requirements to be considered as made in the ordinary course of business. First, Agreement is for the bona fide business purpose of furthering Company Purpose. Second, the transfer from Executive and Trusts to Non-Contributing Shareholders is at arm's length because the transaction is a business transaction, the parties act in their own self-interest and are not subject to pressure from the other parties, and the Non-Contributing Shareholders are not related to Executive or Trusts. Finally, the transfer is made without donative intent because the transfer is made for the sole purpose of furthering Company Purpose. Accordingly, the indirect transfer from Executive and Trusts to the Non-Contributing Shareholders is deemed to be made for adequate and full consideration in money or money's worth. Therefore, based on the facts presented and the representations made, the transfers made to the Non-Contributing Shareholders pursuant to Agreement do not constitute gifts from Executive or Trusts.
>
> By entering into Agreement, each party is increasing the value of the shares held by others (i.e., Executive is increasing the value of the shares held by Trusts, Trusts are increasing the value of shares held by Executive, and each individual trust is increasing the value of each other individual trust). The transfers between Executive and Trusts are not at arm's length, and, therefore, they are not made in the ordinary course of business. However, under Agreement, Executive and Trusts are each surrendering an equal proportion of their shares of Company, and, consequently, the value of the indirect transfers made by each of the parties to the Agreement will be equal to the value of the indirect transfers received by each party. Accordingly, the indirect transfers made from Executive to Trusts and from Trusts to Executive (and each other trust) are made for full and adequate consideration in money or money's worth. Therefore, based on the facts presented and the representations made, the Contributing Shareholders will not be subject to gift tax under sections 2501, 2511, 2512, and regulations thereunder as a result of the Proposed Transaction.

Some of the shares involved were in GRATs. The IRS concluded the shares leaving GRAT 4 were part of an investment, not a distribution:

> The terms of GRAT 4 prohibit distributions to anyone other than Executive during the term of Executive's interest in GRAT 4 in accordance with § 25.2702-3(d)(3). Under the terms of Agreement, the contribution of shares to Company and resulting indirect transfer from GRAT 4 to Executive and Non-Contributing

> Shareholders will be made for adequate and full consideration in money or money's worth within the meaning of § 25.2511-1(g)(1). Accordingly, such transfers are not characterized as distributions from GRAT 4. These transfers are deemed investments because GRAT 4 receives or is deemed to receive value in money or money's worth equal to the transfer. As a result, GRAT 4 will not violate the terms of the trust instruments or the requirement under § 25.2702-3(d)(3) prohibiting a distribution for the benefit of any person other than Executive during the term of Executive's qualified interest. Therefore, based on the facts presented and the representations made, Executive's interest in GRAT 4 will not cease to qualify as a qualified interest under § 25.2702-3 or otherwise under section 2702(b) as a result of the Proposed Transaction.

5. Gifts Not Disproven, Deductions Not Allowed. Estate of Richard D. Spizzirri, T.C. Memo. 2023-25. The gift portion of Spizzirri is fun:

> The Estate failed to meet its burden to prove that Mr. Spizzirri's significant payments to various family members and friends from 2011 through 2015 were not gifts subject to the gift tax. From 2011 through 2015, Mr. Spizzirri paid sizable sums to one of his daughters, one of his stepdaughters, and seven women with whom he had social or romantic relationships.
>
> The Estate argues that the payments to these individuals were not taxable gifts but rather payments for care and companionship services during the last years of his life. In support, the Estate offered the testimony of one of Mr. Spizzirri's daughters, his executor, and one of his lawyers.
>
> We first note that the Estate's failure to call the recipients themselves (aside from Mr. Spizzirri's daughter) could give rise to an adverse inference that, had they been called, their testimony would not have supported the Estate's contentions. *See Wichita Terminal Elevator Co. v. Commissioner*, 6 T.C. 1158, 1165 (1946), *aff'd*, 162 F.2d 513 (10^{th} Cir. 1947).
>
> Even if we lay aside such an adverse inference, the Estate has failed to establish that Mr. Spizzirri's payments were not gifts. Mr. Spizzirri paid the amounts at issue by checks that contain no indication that they were meant as compensation. Mr. Spizzirri did not issue or related to these payments, nor did he report these payments on his personal income tax returns.
>
> The trial witnesses did not address Mr. Spizzirri's payments to six of the nine recipients at issue, much less establish that the payments to them were not gifts. As to the remaining three recipients, the trial testimony reflected that they helped Mr. Spizzirri in various ways during the last few years of his life from running errands to staying by his bedside when he was in the hospital.
>
> The testimony did not resolve, however, whether Mr. Spizzirri's payments to them were anything other than gifts to express his appreciation to loyal and steadfast friends. As Mr. Spizzirri's lawyer put it: "I knew him to say these women were his friends. And that's why he was generous with them." For her part, Mr. Spizzirri's daughter could shed a little more light on her father's affairs, testifying that one of the women who helped him "sort of did everything—like a secretarial— wife—I don't know."
>
> In short, the documentary and testimonial evidence fails to clear up the murky relationship between Mr. Spizzirri and the recipients of his payments, and thus is insufficient to establish that the payments at issue were not gifts.

The court noted that none of these women received a W-2, Form 1099, or any other tax report.

The decedent was married to wife number four, Ms. Lueders, but estranged. They had a prenuptial agreement with numerous amendments. Those provided that at his death:

> • She would receive his interest in his New York City penthouse plus $6 million (or 1/5 of his gross estate);
>
> • She would receive the right to reside at his house in the Hamptons for five years free of charge; and
>
> • Each of her children from a previous marriage would receive $1 million.

He never executed a Will that complied with the prenuptial agreement. He executed his only will in 1979 and four codicils beginning in 2014. His will, as modified, essentially bequeathed his estate to his children and his Miami condominium to the woman—not his wife—with whom he purchased it.

The estate tried to claim payments required by the prenuptial as an estate tax deduction but the Tax Court refused to be persuaded:

> The Estate claimed a deduction under section 2053(a)(3) for the bequests of $1 million to each of Ms. Lueders's three children and the value of her five-year right to reside in the Easthampton property. These claims do not satisfy either the bona fide or the consideration requirements, however.
>
> As an initial matter, the claims were not contracted bona fide but were "essentially donative in character." Treas. Reg. § 20.2053- 1(b)(2)(i). Ms. Lueders's right to reside in the Easthampton property and the payments of $1 million did not stem from the performance under an agreement between Mr. Spizzirri and the various beneficiaries. *See* Treas. Reg. § 20.2053-1(b)(2)(ii)(D); *see also Estate of Woody v. Commissioner*, 36 T.C. 900, 904 (1961). To the contrary, these bequests were testamentary gifts, *see* Treas. Reg. § 20.2053-1(b)(2)(ii)(B), as evidenced by the Prenup's description (echoed in the Third Modification) that the provisions in Article IV were "in lieu of any other rights which may be available to [Ms. Lueders] as [Mr. Spizzirri's] surviving spouse" and the requirement that Mr. Spizzirri "make and keep in effect a will" embodying these arrangements. Nor has the Estate provided any evidence that Ms. Lueders and her children included these amounts as income, as might belie the conclusion that the payments under Article IV were gifts. *See id.* subdiv. (ii)(E).
>
> We likewise conclude that the claims were not contracted for with adequate and full consideration in money or money's worth. In New York, prenuptial agreements are governed by traditional rules of contract interpretation. *Van Kipnis v. Van Kipnis*, 900 N.E.2d 977, 980 (N.Y. 2008). "As with all contracts, prenuptial agreements are construed in accord with the parties' intent, which is generally gleaned from what is expressed in their writing." *Id*. The parties here clearly took pains to keep the consideration for the relinquishment of each right separate and distinct, and we will not second guess their expressed intention.
>
> Article IV of the Prenup addresses the parties' "waiver and release . . . of all rights in and to each other's estate" as surviving spouses. As relevant here, Ms. Lueders

agreed to accept, inter alia, the right to reside in Easthampton for five years and a payment of $1 million to each of her children "in lieu of any other rights which may be available to her as the surviving spouse" of Mr. Spizzirri. The Prenup (as revised by the Third Modification) makes plain that the consideration for the claims at issue is Ms. Lueders's waiver of her marital rights, which runs directly contrary to the prohibition staked out in section 2043(b).

The Estate responds that the claims at issue were supported by Ms. Lueders's waivers of spousal support and equitable distribution, asserting that the value of the waivers exceeded the value of the claims at issue. The Prenup refutes the Estate's argument, expressly specifying the property that Ms. Lueders would receive in the event of a dissolution of marriage "in consideration of her relinquishment of any rights she has or might have at such time to maintenance or support and any claims she has or might have to equitable distribution." The property promised to Ms. Lueders in Article V in consideration for the waiver of her spousal rights in the case of divorce is distinct from the property settled on Ms. Lueders and her children in Article IV (as modified) in exchange for inheritance rights. We see no reason to redraft the parties' agreement to reallocate the consideration that they specified for the relinquishment of certain rights. *See Estate of Morse v. Commissioner*, 69 T.C. 408, 418 (1977) ("[A] consideration hypothetically full and adequate within the statutory meaning has no relevance if the asserted consideration was not part of the bargain between the parties."), *aff'd per curiam*, 625 F.2d 133 (6th Cir. 1980).

Although we have had occasion previously to examine consideration in the context of "simple" antenuptial agreements, we do not believe that those agreements are apposite and thus our previous holdings provide no support to the Estate here. *See Estate of Pollard*, 52 T.C. at 744; *see also Estate of Herrmann v. Commissioner*, 1995 WL 84623, at *7–8. "[T]he determination whether the transaction imports a single contract or several contracts depends not on the number of promises or the number of things promised but on whether there has been a single expression of mutual assent to all the promises as a unit or whether the parties expressed their assent separately to the various promises." 15 Williston on Contracts (Williston) § 45:3 (4th ed. 2022). *Pollard* and *Herrmann* involved straightforward antenuptial agreements "in which the various obligations [were] mutually interdependent." *Estate of Pollard*, 52 T.C. at 744; *see also Estate of Herrmann v. Commissioner*, 1995 WL 84623, at *2–4, *7–8; 15 Williston § 45:3 (describing general dependency as a contract where "all the promised performances on both sides must be regarded as the agreed exchange for each other").

The Prenup, on the other hand, sets forth a highly reticulated scheme, with each article addressing a specific right and detailing the corresponding consideration. In this case, "the performance of a promise on one side may, by the terms of the agreement, be set off as an agreed exchange for a corresponding performance on the other side, although these performances may not be all the performances which the contract requires." 15 Williston § 45:3. In short, *Pollard* and *Herrmann* involve a type of contract different from the Prenup, in which there is "particular dependency between these promises of partial performance." *Id*. The result of the previous cases thus does not obtain.[8]

With respect to the full and adequate consideration issue, the opinion notes (footnote 8):

[8]Even if we were to conclude that we should not treat distinct articles distinctly, the Estate would fare no better. We and other courts have previously

> determined that the waiver of spousal support rights attendant to the dissolution of a marriage can constitute full and adequate consideration. *See, e.g.*, *Estate of Kosow v. Commissioner*, 45 F.3d at 1531–34; *Estate of Fenton*, 70 T.C. at 275. Courts have considered that a waiver of spousal support rights (or agreement to accept lesser support) as part of the arm's-length negotiations surrounding such a dissolution can constitute adequate consideration as it essentially augments the income of the spouse who otherwise would be responsible for support payments under state law. *See, e.g.*, *Estate of Kosow v. Commissioner*, 45 F.3d at 1531–34; *Leopold*, 510 F.2d at 624. This situation differs from one where a spouse prospectively trades away in an antenuptial agreement an unrealized, contingent right to support or maintenance in exchange for "the right to a definite part of her husband's estate." *See Estate of Herrmann v. Commissioner*, 85 F.3d at 1040–41. In that instance, "[w]hat [the waiving spouse] gave up added nothing to her [spouse's] estate; what she received depleted it." *Id*. at 1041. Similarly, Ms. Lueders's prospective relinquishment of her spousal support rights in the Prenup does not constitute full and adequate consideration.
>
> We likewise reject the Estate's argument that the payments to Ms. Lueders's children qualified for the marital deduction of section 2056(a), as the payments were plainly not made to Mr. Spizzirri's surviving spouse. *See Estate of Spencer v. Commissioner*, 43 F.3d 226, 231 (6th Cir. 1995), *rev'g* T.C. Memo. 1992-579.

The court also refused to excuse late filing because of Ms. Lueder's litigation. The court noted the requirement is to file on the best information possible, and then file an amended return:

> The Estate acknowledges that it did not file a timely return but asserts that its failure was due to reasonable cause and not willful neglect. Specifically, the Estate identifies Ms. Lueders's probate litigation as the reason for the delay, claiming that it did not want to file an incomplete or misleading return. The Estate, however, "was required to file a timely estate tax return based upon the '"best information available"' and then, if necessary, file an amended return." *Estate of Wilbanks v. Commissioner*, T.C. Memo. 1991-45*,* 1991 WL 11522, *aff'd*, 953 F.2d 651 (11th Cir. 1992); *see also* Treas. Reg. § 20.6081-1(c) and (d). We see nothing to indicate that the probate litigation deprived the Estate of sufficient information to file a proper return.
>
> The Estate further claims that it had reasonable cause for failing to file the estate tax return because it relied upon its tax return preparer to obtain a second extension of the filing date. Although Mr. Langer attempted to obtain a second extension, he credibly testified that he advised the Estate to file the return before the August 12, 2016, extended deadline. The Estate thus fails to establish that it reasonably relied on professional . *Commissioner*, T.C. Memo. 2022-102, at *8.

With respect to an amended return, Treas. Reg. § 20.6081-1(d) states:

> A return as complete as possible must be filed before the expiration of the extension period. The return thus filed will be the return required by section 6018(a), and any tax shown on the return will be the amount determined by the executor as the tax referred to in section 6161(a)(2), or the amount shown as the tax by the taxpayer upon the taxpayer's return referred to in section 6211(a)(1)(A). The return cannot be amended after the expiration of the extension period although supplemental information may subsequently be filed that may result in a finally determined tax different from the amount shown as the tax on the return.

The Eleventh Circuit was asked to review the deductibility of the payments to the step-children. ___________________ (11^{th} Cir. 2025). The court affirmed the Tax Court. The opinion states:

> As a preliminary matter, the estate argues that it shifted its burden of proving entitlement to the deduction to the Commissioner. The taxpayer bears the initial burden of proving entitlement to a deduction. *See Kosow*, 45 F.3d at 1531 (requiring the taxpayer to prove that the "statutory conditions to the [claimed] deduction" were met). The taxpayer may shift the burden of proof to the Commissioner if the taxpayer introduces "credible evidence" that he is entitled to a deduction. 26 U.S.C. § 7491(a). To shift the burden, the taxpayer must also comply with the requirements to "substantiate any item" and "maintain[] all records required." *Id*. § 7491(a)(2)(A)– (B).
>
> We agree with the Commissioner that the estate failed to introduce the "credible evidence" necessary to shift the burden. *Id*. § 7491(a). The estate's expert testified that Spizzirri agreed to make payments "to keep [Lueders] happy" and "show[] largesse to her children" and "was doing what he could to keep [Lueders] intact and married to him." The estate also failed to call the stepchildren as witnesses though it could have asked them whether they reported the payments as income.
>
> The "bona fide" requirement in section 2053(c)(1)(A) bars a deduction for a claim "to the extent it is founded on a transfer that is essentially donative in character (a mere cloak for a gift or bequest)." Treas. Reg. § 20.2053-1(b)(2)(i) (2009). In transactions between family members, "a testator is mo[re] likely to be making a bequest . . . than repaying a real contractual obligation." *Huntington*, 16 F.3d at 466. So we "subject [those transactions] to particular scrutiny, even when they apparently are supported by monetary consideration." *Id.* Because Spizzirri's stepchildren were "lineal descendants of . . . [his] spouse," we apply the same "particular scrutiny" to the estate's payments to the stepchildren that we do to transactions between family members. *See* Treas. Reg. § 20.2053- 1(b)(2)(iii)(A) (defining "[f]amily members" as including the "spouse of the decedent" and "lineal descendants" of "the decedent's spouse").
>
> To guide our evaluation of intrafamily transfers, the Treasury Regulations list five factors that suggest a transfer was contracted bona fide. *Id*. § 20.2053-1(b)(2)(ii). First, "[t]he transaction underlying the claim . . . occurs in the ordinary course of business, is negotiated at arm's length, and is free from donative intent." *Id*. § 20.2053-1(b)(2)(ii)(A). Second, the claim "is not related to an expectation or claim of inheritance." *Id*. § 20.2053-1(b)(2)(ii)(B). Third, the claim "originates pursuant to an agreement between the decedent and the family member." Id. § 20.2053-1(b)(2)(ii)(C). Fourth, "[p]erformance by the claimant" stems from "an agreement between the decedent and the family member." *Id*. § 20.2053-1(b)(2)(ii)(D). Fifth, "[a]ll amounts paid in satisfaction or settlement of a claim or expense are reported by each party for Federal income and employment tax purposes . . . in a manner that is consistent with the reported nature of the claim or expense." *Id*. § 20.2053- 1(b)(2)(ii)(E).

The nub of the estate's problem was that the payments to the step-children had no business purpose and thus looked like gift or inheritance transfers. The step-children performed no services for the decedent.

O. SECTION 2518 – DISCLAIMERS

P. SECTIONS 2601-2654 - GENERATION-SKIPPING TRANSFER TAX

1. Timely Allocation of GST Exemption and Certain GST Elections. TD 9996 (May 6, 2024). On April 17, 2008, proposed regulations under section 2642(g)(1) were issued that set forth the standards that the IRS will apply in determining whether to grant a transferor or a transferor's estate an extension of time to make an allocation of GST exemption, as described in section 2631, to property transferred by the transferor and the following three elections under section 2632: (1) an election under section 2632(b)(3) not to have the automatic allocation of GST exemption apply to a direct skip; (2) an election under section 2632(c)(5)(A)(i) not to have the automatic allocation of GST exemption apply to an indirect skip or to transfers made to a particular trust; and (3) an election under section 2632(c)(5)(A)(ii) to treat any trust as a GST trust for purposes of section 2632(c).

In the intervening years, the IRS received only five comments. One key element of these Final Regulations is that section 9100 relief is not available for late allocations. The Background states:

> On and after the date of publication of these final regulations, relief under section 2642(g)(1) no longer will be granted under § 301.9100-3. In addition, because these final regulations provide a replacement for the automatic six-month extension under § 301.9100-2(b) without substantive difference, the extension under § 301.9100-2(b) no longer will be available to transferors or transferor's estates qualifying for relief under proposed § 26.2642-7(h)(1), redesignated in the final regulations as § 26.2642-7(i)(1), on and after the date of publication of these final regulations. Accordingly, the final regulations amend §§ 301.9100-2(b) and 301.9100-3 to provide that relief under section 2642(g)(1) cannot be obtained through the provisions of §§ 301.9100-2(b) and 301.9100-3. However, requests that are pending with the IRS on the date of publication of these final regulations will continue to be processed under the section 9100 provisions unless the taxpayer requesting relief opts to withdraw the request and instead seek relief under these final regulations. In that case, the taxpayer's user fee will be refunded and a new user fee will be required with the new request.

The Background also notes that the IRS will be issuing new proposed regulations to "complement" these Final Regulations:

> In contrast to these final regulations, which address the standards for granting relief under section 2642(g)(1) for a failure to make a timely allocation or election, the forthcoming proposed regulations would address the practical effect of a grant of relief and would clarify the interplay between affirmative allocations and automatic allocations. Paragraphs in these final regulations have been reserved to accommodate the forthcoming proposed regulations.

The Background goes to great lengths to remind us that no one factor is decisive in determining whether relief is allowed:

> Section 2642(g)(1) directs the Treasury Department and the IRS to issue regulations that "prescribe such circumstances and procedures" under which the IRS will grant relief. Since the enactment of section 2642(g) and through the IRS private letter ruling program, the IRS has applied a facts and circumstances

> methodology in considering requests for relief. Given the inherent complexity of the GST exemption rules, no single factor can be determinative. While § 301.9100-3(b)(1) deems the reasonableness and good faith requirements to have been met if the taxpayer establishes any one of the factors therein, that rule is expressly made subject to the requirement of the absence of the use of hindsight and the other factors described in § 301.9100-3(b)(3) and (c), and thus is not a one-factor test. Accordingly, proposed § 26.2642-7(d)(2) seeks to delineate the many factors implicit in such a facts and circumstances inquiry, and the final regulations adopt the same methodology.
>
> The IRS's experience with requests for relief under section 2642(g)(1) indicates that no one factor has more importance in all cases than any other factor. Further, the satisfaction of one factor alone may or may not be sufficient, in the context of the facts and circumstances of that particular taxpayer, to persuade the IRS that relief under section 2642(g)(1) is warranted. Therefore, the recommendation to allow one factor to be determinative has not been adopted in the final regulations. Nevertheless, the final regulations clarify that not all of these factors may be relevant in a particular situation (and those that are not relevant would not need to be addressed in the request for relief). In addition, based on all the facts and circumstances, a single factor listed in § 26.2642-7(d)(2) may (or may not) be determinative.

Having said that, the IRS is clearly influenced by certain things. For example, it is likely helpful if the taxpayer files before discovery by the IRS:

> Section 301.9100-3(b)(1)(i) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer requests relief before the failure to make the regulatory election is discovered by the IRS. A commenter requested that this circumstance be added to the factors listed in this provision. Thus, a taxpayer would be considered to have acted reasonably and in good faith if the taxpayer's request for relief was filed before the failure to make the allocation or regulatory election is discovered by the IRS. For purposes of section 2642(g)(1), the Treasury Department and the IRS have determined that this circumstance is not material because, in the context of a request for relief under section 2642(g)(1), the Treasury Department and the IRS believe that the party that first discovers the failure to make the allocation or election (be it the IRS or the taxpayer) generally has no correlation with the taxpayer's good faith or reasonable action. Particularly because of the significant length of time that often elapses between the transfer and the discovery of a missed GST election or allocation, the discovery by the IRS does not necessarily signify a lack of good faith or reasonable action by the taxpayer. At the same time, the taxpayer's discovery generally does not guarantee the existence of good faith and reasonable action by the taxpayer. Therefore, this factor has not been added to the final regulations. However, a delay in requesting relief, after the need for relief is discovered, may have an adverse effect on the availability of relief. See, for example, the circumstances described in § 26.2642-7(d)(3)(ii) and (e)(3).

Other factors are spelled out in the regulations:

> (2) Reasonableness and good faith. The following is a nonexclusive list of factors that will be considered in determining whether the transferor or the executor of the transferor's estate acted reasonably and in good faith for purposes of this section. Not all of these factors may be relevant in a particular situation (and those that are not relevant are not required to be addressed in the request for relief made

in accordance with paragraph (i) of this section). Further, it is possible that the evidence relating to any one of these factors, in the context of all of the facts and circumstances of the particular situation, may be sufficient to persuade the IRS that the grant of relief under section 2642(g)(1) would be appropriate. However, as a general rule, no single factor (whether listed or not) will be determinative in all cases. The factors are as follows:

(i) Intent. The intent of the transferor to timely allocate GST exemption to a transfer or to timely make an election under section 2632(b)(3) or (c)(5), as evidenced in the trust instrument, the instrument of transfer, or other relevant documents contemporaneous with the transfer, such as Federal gift and estate tax returns and correspondence. This may include evidence of the intended GST tax status of the transfer or the trust (for example, exempt, non-exempt, or partially exempt), or more explicit evidence of intent with regard to the allocation of GST exemption or the election under section 2632(b)(3) or (c)(5).

(ii) Intervening events. Intervening events beyond the control of the transferor or of the executor of the transferor's estate that caused the failure to allocate GST exemption to a transfer or the failure to make an election under section 2632(b)(3) or (c)(5).

(iii) Lack of awareness. Lack of awareness, despite the exercise of reasonable diligence, by the transferor or the executor of the transferor's estate of the need to allocate GST exemption to the transfer, taking into account the experience of the transferor or the executor of the transferor's estate and the complexity of the GST tax issue, as the cause of the failure to allocate GST exemption to a transfer or to make an election under section 2632(b)(3) or (c)(5).

(iv) Consistency. Consistency by the transferor with regard to the allocation of the transferor's GST exemption to one or more trusts or skip persons. For example, the transferor's consistent pattern of allocation of GST exemption to transfers (whether or not made in consecutive years) to skip persons or to a particular trust, or the transferor's consistent pattern of electing not to have the automatic allocation of GST exemption apply to transfers (whether or not made in consecutive years), will be taken into consideration. Evidence of consistency may be less relevant if there has been a change of circumstances or a change of trust beneficiaries that otherwise would explain a deviation from prior GST exemption allocation decisions. Relief under this section will not be denied merely because a pattern of allocation or election does not exist or because the existing pattern changed at some point, whether in response to the enactment of section 2642(g) or to some other factor unrelated to either a lack of reasonableness or good faith or prejudice to the interests of the government.

(v) Qualified tax professional. Reasonable reliance by the transferor or the executor of the transferor's estate on the advice of a qualified tax professional retained or employed by one or both of them and either the failure of the tax professional, or, in reliance on or consistent with (or in the absence of) that tax professional's advice, the failure of the transferor or the executor, to allocate GST exemption to the transfer or to make an election described in section 2632(b)(3) or (c)(5). Reliance on a qualified tax professional will not be considered to have been reasonable if the transferor or the executor of the transferor's estate knew or should have known that the professional either—

(A) Was not competent to render advice on the GST exemption; or

(B) Was not aware of all relevant facts.

(3) Prejudice to the interests of the government. The following is a nonexclusive list of factors that will be considered to determine whether the interests of the government would be prejudiced for purposes of this section:

(i) Hindsight. An attempt to benefit from hindsight will be deemed to prejudice the interests of the government. A factor relevant to this determination is whether the grant of the requested relief would permit an economic advantage or other benefit that would not have been available if the allocation or election had been timely made. For example, there may be prejudice if a grant of the requested relief would permit an economic advantage or other benefit that results from the selection of one out of a number of alternatives (other than whether or not to make an allocation or election) that were available at the time the allocation or election could have been timely made, if hindsight makes the selected alternative more beneficial than the other alternatives. Prejudice also would exist if the transferor failed to make the allocation or election in order to wait to see (thus, with the benefit of hindsight) whether making an allocation of exemption or election would be more beneficial than not making the allocation or election. For instance, assume that a transferor funds several trusts with different property interests on the same date, and does not allocate GST exemption to any trust. Several years later, the transferor seeks relief to allocate GST exemption to the trust that enjoyed the greatest asset appreciation and thus constitutes the most effective use of the transferor's GST exemption. Relief will not be granted because the transferor attempted to benefit from hindsight and thereby acquire an economic advantage.

(ii) Timing of the request for relief. The timing of the request for relief will be considered in determining whether the interests of the government would be prejudiced by granting relief under this section. The interests of the government would be prejudiced if delay by the transferor or the executor of the transferor's estate in the filing of the request for relief was intended to deprive the IRS of a sufficient period of time in which to challenge any element of the transfer that is the subject of the request for relief, such as the value of the transferred property for Federal gift or estate tax purposes, the claimed identity of the transferor of the transferred property, or any other aspect of the transfer that is relevant for Federal gift or estate tax purposes. For this purpose, such intent will be presumed, but may be rebutted by evidence persuasive to the IRS of the existence of other reasons for or circumstances causing the delay.

(iii) Intervening taxable events. The occurrence and effect of an intervening taxable termination or taxable distribution will be considered in determining whether and to what extent the interests of the government would be prejudiced by a grant of relief under this section. The interests of the government may be prejudiced if a taxable termination or a taxable distribution occurred between the time for making a timely allocation of GST exemption or a timely election described in section 2632(b)(3) or (c)(5) and the time at which the request for relief under this section was filed. The impact of a grant of relief on (and the difficulty of adjusting) the GST tax consequences of that intervening termination or distribution will be considered in determining whether the occurrence of a taxable termination or taxable distribution constitutes prejudice.

(iv) Closed years. Subject to the considerations described in paragraph (d)(3)(ii) of this section, the expiration of any period of limitations on the assessment or collection of transfer taxes prior to the filing of a request for relief under this section generally is not relevant to the determination of whether the requirements for a grant of relief under this section have been met. If that period has expired, however, and if the IRS concludes that the value of the transferred asset or assets as reported on a Federal gift or estate tax return by the transferor or the executor

> of the transferor's estate is likely to have satisfied the definition of a gross valuation misstatement as defined in section 6662(h)(2)(C) of the Code, the IRS will consider the purported undervaluation in determining whether a grant of relief will prejudice the interests of the government.

Where a previous allocation of GST exemption has been made, ordinarily relief will not be granted to make a change. But in certain instances, the general rule does not apply:

> (2) Affirmative allocations—(i) In general, relief will not be granted under this section to the extent that it would decrease or revoke an affirmative (but not automatic) allocation of GST exemption under section 2632(a) or 2642(b) that was made on a Federal gift or estate tax return, regardless of whether the transfer or the allocation of exemption was made during the transferor's life or upon the transferor's death.
>
> (ii) There are three exceptions to this general rule, as follows. No request for relief is required for either of the first two exceptions:
>
> (A) An allocation of GST exemption is void to the extent the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero with respect to the property transferred or to the trust. This provision does not apply to charitable lead annuity trusts, nor does it apply to an allocation made to a trust subject to an estate tax inclusion period before the termination of that period. See § 26.2632-1(b)(4)(i).
>
> (B) An allocation is void if the allocation is made with respect to a trust that, at the time of the allocation, has no GST potential with respect to the transferor making the allocation. For this purpose, a trust has GST potential even if the possibility of a GST is so remote as to be negligible. See § 26.2632-1(b)(4)(i).
>
> (C) A late allocation of GST exemption, as described in section 2642(b)(3), to a transfer or to a trust will be deemed void upon the grant of relief under this section if—
>
> (1) Prior to December 31, 2000, a transfer is made that is subject to GST tax or to a trust that has GST potential with respect to the transferor;
>
> (2) A timely allocation of GST exemption was not made to the transfer or the trust, and this missed allocation was not eligible for relief prior to the enactment of section 2642(g)(1);
>
> (3) Prior to December 31, 2000, a late allocation of GST exemption was made to the transfer or the trust;
>
> (4) The late allocation is disclosed as part of the request for relief or during the IRS's consideration of that request; and
>
> (5) Relief under this section is granted to make a timely allocation to the transfer or the trust described in paragraph (e)(2)(ii)(C)(1) of this section.
>
> (3) Timing. Relief will not be granted with regard to a transfer reported on the transferor's gift tax return in the situation in which the transferor filed the request for relief shortly after the expiration of the period during which an assessment of gift tax could be made with respect to that transfer, the IRS reasonably concludes

> that the transferor intentionally delayed that filing for the purpose of preventing an IRS examination of the reported value of the property subject to that transfer or the claimed identity of the transferor or other fact relevant for transfer tax purposes, and the transferor is unable to produce evidence sufficient to convince the IRS that the filing delay was attributable to some other reason or purpose.
>
> (4) Failure after being accurately informed. Relief will not be granted under this section if the decision made by the transferor or the executor of the transferor's estate (who had been accurately informed in all material respects by a qualified tax professional retained or employed by either (or both) of them with regard to the allocation of GST exemption or an election described in section 2632(b)(3) or (c)(5)) was reflected or implemented by the action or inaction that is the subject of the request for relief.
>
> (5) Hindsight. Relief under this section will not be granted if the IRS determines that the requested relief is an attempt to benefit from hindsight by waiting to see which of multiple transfers, made at substantially the same time but consisting of different property interests, enjoyed the greatest appreciation and thus would constitute the most effective use of the transferor's GST exemption.

2. <u>Extension of Time Allowed to Taxpayer to Elect Out of GST Exemption Automatic Allocation</u>. PLR 202449004 involved GST exemption inadvertently allocated at the end of a GRAT's two-year term. The ruling notes these facts:

> On Date of Year 1, a date after December 31, 2000, Taxpayer established and funded Trust, an irrevocable grantor retained annuity trust (GRAT). Taxpayer's retained interest in Trust terminated on Date of Year 2, with the remaining principal transferred to Remainder Trust for the benefit of certain relatives and friends of Taxpayer. Remainder Trust has GST potential. For GST tax purposes, the estate tax inclusion period (ETIP) with respect to Taxpayer's transfer to Trust closed on Date of Year 2, at which time an indirect skip is deemed to have been made.

The request was granted. Reliance on the law firm may have been the key factor:

> Taxpayer engaged Law Firm in connection with the formation of Trust. At the time of Taxpayer's Year 1 transfer to Trust, Taxpayer relied on Accounting Firm to prepare and file Taxpayer's tax returns. Taxpayer did not intend for any portion of Taxpayer's GST exemption to be allocated to property transferred to Remainder Trust. Law Firm and Accounting Firm, however, did not advise Taxpayer that under § 2632(c), a portion of Taxpayer's GST exemption would be automatically allocated to the property transferred to Remainder Trust. In addition, Law Firm and Accounting Firm did not advise Taxpayer of the ability to elect out of the automatic allocation of GST exemption by making an election under § 2632(c)(5) on Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return). As a result, Taxpayer failed to make a timely election on a Form 709 to opt out of the automatic allocation of GST exemption to the property transferred to Remainder Trust. In Year 3, after Taxpayer's GST exemption was automatically allocated to the property transferred to Remainder Trust, Attorney discovered the failure to opt out.
>
> It has been represented that, to date, no taxable distributions, taxable terminations, or any other events have occurred with respect to Trust or Remainder Trust that would give rise to a GST tax liability.

3. **Trust Extension Will Not Affect GST If the Beneficiary Has A General Power**. In PLR 202446006, the pertinent facts were described in the ruling as follows:

> Accordingly, each trust provides that after the death of Daughter, when the child beneficiary of the trust attains the age of x, one-half of that trust's property is to be distributed to the child, and when the child beneficiary attains the age of y, all of that trust's remaining property is to be distributed to the child.
>
> At the present time, Daughter is living. Daughter has two living children, Grandchild A and Grandchild B, each of whom have attained age y. Trust 1A is the trust for the benefit of Grandchild A and Trust 1B is the trust for the benefit of Grandchild B.
>
> State Statute provides that the court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust. To the extent practicable, the modification must be made in accordance with the settlor's probable intention. The court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration. Upon termination of a trust under this section, the trustee shall distribute the trust property as ordered by the court.
>
> On Date 3, the trustee of Trust 1A petitioned Probate Court to modify the terms of Trust 1 as they apply to Trust 1A. Per the petition, Item II(e) of Trust 1A is modified to provide that the trust is to be held and administered in trust for Grandchild A's lifetime. Upon the death of Grandchild A, any remaining undistributed principal and income is to be distributed in such manner as Grandchild A directs or appoints, including the power to appoint such property to her creditors or the creditors of her estate, by making a specific reference to this general power of appointment in her last will and testament. If Grandchild A fails to effectively appoint any part of her trust, then such share of the trust is to be distributed *per stirpes* among her descendants then living and if none, then *per stirpes* among the descendants of Grantor who are still living.
>
> On Date 4, Probate Court ordered that Trust be modified, contingent upon a favorable ruling from the Internal Revenue Service. The Court found that circumstances have changed such that it is in the best interests of Grandchild A that Trust 1A should not terminate upon the death of Daughter, but instead should last for the lifetime of Grandchild A. Because of the relatively large values of the assets within Trust 1A, Grandchild A will continue to need guidance, management, investment advice, and distribution assistance from a professional trustee. The modification to keep Grandchild A's inheritance in trust for her lifetime furthers the essential purpose of Trust 1A to provide financially for Grantor's grandchildren.

The IRS concluded there would be no GST effect:

> In the present case, the proposed modification of Trust 1A, under State Statute, provides that Grandchild A's interest in Trust 1A will continue to be held in trust for the exclusive benefit of Grandchild A during her lifetime. Instead of terminating upon the death of Daughter, Trust 1A will continue to be a trust until the death of Grandchild A. The assets of Trust 1A will be subject to Grandchild A's testamentary general power of appointment and will be included in Grandchild A's gross estate for federal estate tax purposes.

> The proposed modification of Trust 1A will not result in a shift of any beneficial interest in the trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. In addition, the proposed modification of Trust 1A will not extend the time for vesting of any beneficial interest in the modified trust beyond the period provided for in the original trust. Accordingly, based on the facts presented and the representations made, we find that after the proposed modification of Trust 1A, Trust 1 and Trust 1A will remain exempt from the application of the GST tax and that no distribution from or termination of any interest in Trust 1 or Trust 1A will be subject to the GST tax.

4. <u>Merger of Two Exempt Trusts, Created By Spouses, Is Fine</u>. PLR 202528006 deals with the common situation in which each of two spouses creates a GST exempt trust as part of the estate plan. Later, the family wants to merge them. If they are identical, that's easy:

> Husband's Exempt Trust and Wife's Exempt Trust have the same beneficiaries, and the Trusts' dispositive, administrative, and termination provisions are identical. State's rule against perpetuities does not apply to the Trusts. As a result, the Trusts may remain in existence indefinitely. Pursuant to the merger, the property held in Husband's Exempt Trust will be added to Wife's Exempt Trust, and Husband's Exempt Trust will terminate. Thereafter, all property will be subject to the terms of Wife's Exempt Trust. After the merger, all property will be subject to the same terms to which it was subject before the merger. Accordingly, the merger does not shift a beneficial interest in the trusts to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trusts.
>
> Accordingly, based on the information submitted and the representations made, we conclude that the proposed merger of Husband's Exempt Trust into Wife's Exempt Trust will not affect the present GST tax exempt status of such trusts and will not cause any distributions (upon termination or otherwise) from Wife's Exempt Trust to its beneficiaries to become subject to the GST tax.

Q. <u>SECTIONS 2701-2704 - SPECIAL VALUATION RULES</u>

1. <u>How Might The Doctrine Of Merger Be Used With A GRAT?</u> Because a trust is created by separating legal and equitable title to property, merging legal and equitable title to property in one person will, in general, cause the trust to terminate. The doctrine of merger is incorporated in section 402(a)(5) of the UTC, the comment to which states:

> Subsection (a)(5) addresses the doctrine of merger, which, as traditionally stated, provides that a trust is not created if the settlor is the sole trustee and sole beneficiary of all beneficial interests. The doctrine of merger has been inappropriately applied by the courts in some jurisdictions to invalidate self-declarations of trust in which the settlor is the sole life beneficiary but other persons are designated as beneficiaries of the remainder. The doctrine of merger is properly applicable only if all beneficial interests, both life interests and remainders, are vested in the same person, whether in the settlor or someone else. An example of a trust to which the doctrine of merger would apply is a trust of which the settlor is sole trustee, sole beneficiary for life, and with the remainder payable to the settlor's probate estate.

The Restatement (Third) of Trusts § 69, Comment b, states that "[i]f, by operation of law, the legal title to the trust property passes to the beneficiary who has the entire beneficial interest, merger occurs, the trust terminates, and the beneficiary holds the property free of trust. Where the life interest and remainder interest is held by two beneficiaries who are also the only co-trustees, whether merger occurs in favor of the two beneficiaries is uncertain. See Scott and Ascher on Trusts § 11.2.5.

Suppose the grantor and the remainder beneficiaries contribute their respective interests to an LLC in exchange for membership interests that are proportionate to the interests of each such that the grantor receives an interest equal in value to the amount that would be included in the grantor estate if she died at that moment. The LLC would have all the beneficial interests in the GRAT property. If the LLC could become trustee of the GRAT then the doctrine of merger ought to apply. May an LLC serve as trustee? Under the UTC, for example, there is no definition of trustee but there are broad references to "persons" serving as trustee and the definition of person includes entities like an LLC. Some states may impose other limitations. In PLR 201928005, dealing with merger in the context of a GRAT, the IRS notes a state law requirement that a trustee may terminate a CLAT where the annuity and remainder are held by one beneficiary (and concludes the trustee doing so will not cause gain or loss recognition).

Where an LLC cannot serve as trustee, if the LLC managers serve as trustees is that sufficient? The answer is uncertain. The LLC managers are not the LLC.

Would a merger into an LLC be a taxable event for income tax purposes? The answer would seem to be no. Similarly, because the grantor receives an LLC interest having a value equal to what would be in the grantor's estate if the grantor died at that moment concerns like those raised in CCA 201745012 arguably are avoided.

2. Section 2703 Prevents Option Agreement From Setting Value. In Huffman v. Commissioner, T.C. Memo. 2024-12, the IRS asserted that the purchase price paid by son Chet was less than the fair market value of the stock he bought. The background facts were important:

> Dukes was incorporated in 1958 and headquartered in Northridge, California. It manufactured and supplied various engineering components to the aerospace industry. Lloyd and Patricia both worked for Dukes; he initially as a design engineer and she as a bookkeeper.
>
> In 1970 Lloyd was made president of Dukes and acquired 113,365 shares in the company. During Lloyd's time as president Dukes employed two of Lloyd and Patricia's sons: Randy and Lance (Randy and Lance) Huffman.
>
> In January 1979 Lloyd and Patricia formed the Huffman Family Trust (Trust). They appointed themselves trustees of the Trust. Lloyd had his 113,365 shares in Dukes reissued to the Trust. The Trust acquired an additional 5,000 shares in 1990.
>
> Lloyd held the position of Dukes president until 1987. He stepped down from the role after suffering a near fatal car racing accident. Within days of the accident, Lloyd and Patricia's other son, Chet, was made chief executive officer (CEO) and issued 5,000 shares of Dukes (representing 0.7% of the total outstanding shares).

> In March 1990 Lloyd and majority shareholder Robert L. Barneson8 entered into an agreement (Lloyd-Barneson agreement) whereby Lloyd was granted the right to purchase Mr. Barneson's shares. At that time, Mr. Barneson owned 322,241 shares (representing 43% of the total outstanding shares). The Lloyd-Barneson agreement entitled Lloyd to purchase Mr. Barneson's shares upon Mr. Barneson's death or by a right of first refusal for a price not to exceed $2 per share. There was no specific termination or exercise date for purchasing the shares in the agreement.
>
> In June 1993 Lloyd assigned his rights under the Lloyd-Barneson agreement to Chet (Assignment agreement). In August 1993 Chet exercised his assignee rights under the Lloyd-Barneson agreement. By separate agreement (Chet-Barneson agreement), he agreed to pay Mr. Barneson $150,000 for his 322,241 shares with $50,000 being paid upon execution and the remaining $100,000 being paid in equal installments over the following five years. As a result of the purchase, Chet became the majority shareholder of Dukes with 43.7% of the total outstanding shares.
>
> In November 1993 Chet entered into two additional right to purchase agreements (RTP agreements)—one with Dukes Research and Manufacturing, Inc. (DRM), and another with the Trust. DRM was an S corporation owned entirely by Patricia; it owned 304,124 Dukes shares (representing 40.5% of the total number outstanding). The Trust owned 118,635 Dukes shares (representing 15.8% of the total number outstanding).
>
> For a sum of $2 and "other good and valuable consideration," the RTP agreements provided Chet with the right to purchase DRM's and the Trust's Dukes shares for a price not to exceed $3.6 million and $1.4 million, respectively, upon the death of Lloyd and Patricia. Chet could also purchase the shares by virtue of a right of first refusal. The right of first refusal exempted offers from Randy and Lance, Chet's brothers. The parties executed an addendum to the RTP agreements that provided Chet with the option to purchase the shares at any time, in addition to the stated events in the agreements themselves.
>
> Chet was not permitted to sell, assign, or otherwise transfer his rights under the RTP agreements without the consent of the owners. For the RTP agreement between Chet and DRM, Chet had to obtain DRM's consent to override the alienability restrictions. For the RTP agreement between Chet and the Trust, Chet had to obtain Lloyd and Patricia's consent to override the alienability restrictions.
>
> The RTP agreements provided that they were "not compensatory in nature, rather the purpose [was] to retain the ownership of" Dukes within the family. A tax opinion letter Chet obtained from the law firm Proskauer Rose LLP (Proskauer) stated that the purpose behind the RTP agreements "was not compensatory. It was not in connection with the performance of services."

Chet exercised his options in 2007 for $5,000,000.

Section 2703 provides that an option or other agreement is ignored when setting value for transfer tax purposes unless:

> (1) it is a bona fide business arrangement; (2) it 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) its terms are comparable to similar arrangements entered into by persons in an arm's-length transaction.

Here, the court concluded that this was a bona fide business arrangement because that includes maintaining managerial control or family ownership. The court also concluded that the options were not a testamentary device. The court's discussion is instructive:

> We agree with respondent that the rights associated with the RTP agreements were worth substantially more than $2. This finding is supported by both parties' experts' valuations of the agreements. Still, we do not think that the RTP agreements were a testamentary device by which Lloyd and Patricia attempted to pass assets on to their son Chet. We make this determination on the basis of all of the facts and circumstances involved. *See Estate of Morrisette*, T.C. Memo. 2021-60, at *100.
>
> If we viewed the exchange of $2 for the rights under the RTP agreements without considering the circumstances, we would agree that this was an inequitable exchange. While we take note that the agreements themselves purported not to be compensatory, Chet *did* accept a reduced salary during his years as Dukes's CEO. Given his significant contributions to the company, we think that his reduced salary should be deemed consideration for the RTP agreements.
>
> We note the significant amount of earnings growth that would have had to occur for the options to become "in the money." According to respondent's expert, the Dukes shares were worth approximately $0.51 per share in 1993; petitioners' expert says they were worth approximately $0.47 per share. In 2007 Chet was able to purchase the shares for $11.83 per share. If we average the parties' per-share 1993 values ($0.49 per share), the Dukes shares that Chet purchased in 2007 had increased in value by 2,414%.
>
> We view this level of growth as unusual and unexpected. It is supported by the 1993 transaction by which Chet purchased Mr. Barneson's shares for $150,000. Chet and Mr. Barneson—unrelated parties—reached this figure by estimating annual revenue growth for Dukes at 4% per year. Using a 4% growth rate, the shares that Chet was able to purchase via the RTP agreements would have taken between 50 and 70 years to reach an "in the money" value.
>
> We also note that the RTP agreements—though negotiated among family members—did have the characteristics of an arm's-length transaction. Both parties were motivated to reach a fair price. Lloyd and Patricia were willing to part with their shares only for $5 million—an amount which they considered sufficient for their retirement. Chet on the other hand was incentivized to drive this number down so that he could reach the "in the money" value we mentioned above sooner. This incentivized Chet both to stay with the company and to increase its per-share value.
>
> Taking these facts together, we do not think that the RTP agreements were a testamentary device by which Lloyd and Patricia transferred Dukes shares to Chet for less than full consideration. Section 2703(b)(2) is satisfied.

The trouble for the taxpayer was the third requirement: comparability. The taxpayer pointed to the Lloyd-Barneson agreement but did not submit it into evidence. Even if it had been in evidence, the court might have ignored it. The opinion notes:

Petitioners argue that the final section 2703(b) requirement is satisfied by the Lloyd-Barneson agreement, which they claim is comparable to the RTP agreements and was entered into in an arm's-length transaction. Petitioners note that the Lloyd-Barneson agreement contained the following provisions, which are also included in the RTP agreements: (1) a right to purchase on the death of the grantor and by a right of first refusal; (2) a maximum purchase price; and (3) no specific termination or exercise date. Petitioners also point out that the Lloyd-Barneson agreement was entered into by unrelated parties—Lloyd and Mr. Barneson—and executed at arm's length.

Respondent counters that the Lloyd-Barneson agreement cannot serve as a good comparable because it was not submitted into evidence. Respondent notes that there are only two pieces of evidence which describe the Lloyd-Barneson agreement: a one-paragraph reference in the Assignment agreement and another in the Chet-Barneson agreement. Otherwise, the only information provided about the Lloyd-Barneson agreement comes from witnesses' testimony, which made vague references to the agreement.

Respondent contends that even if we are to find that the testimony regarding the Lloyd-Barneson agreement is credible, there are differences among it and the RTP agreements which render the Lloyd-Barneson agreement not a good comparable. The noted differences are that (1) Lloyd Huffman was allowed to freely transfer his rights whereas Chet had to obtain consent from the owners; (2) the right of first refusal in the RTP agreements exempted offers from Chet's brothers; (3) the RTP agreements had an addendum that granted Chet the right to purchase the shares at any time at his discretion; and (4) the stated purpose of the RTP agreements was to retain ownership of Dukes within the Huffman family.

We agree with respondent. As we noted in *Estate of Amlie*, T.C. Memo. 2006-76, slip op. at 41, reliance on an isolated comparable is adequate given that the regulations "delineate more of a safe harbor than an absolute requirement that multiple comparables be shown." Use of the Lloyd-Barneson agreement then would be acceptable to show that the RTP agreements had terms similar to an agreement entered into at arm's-length. But as respondent notes, we do not have the Lloyd-Barneson agreement in evidence. We have only vague and incomplete references to it and testimony based on those references. We do not have an isolated comparable to undergo the section 2703(b)(3) analysis.

Even if we were to accept witnesses' testimony as sufficient evidence, we do not think that the Lloyd-Barneson agreement is sufficiently similar. Even though the three agreements purport to create rights to purchase Dukes shares for a maximum price, the differences among them are significant. For example, Chet had the unfettered right to purchase the Dukes shares at any time and at his sole discretion; Lloyd did not have this same right. Further, Lloyd was permitted to assign or otherwise transfer his purchase rights whereas Chet had to obtain consent to do the same. Chet then had rights superior to Lloyd's in purchasing the shares but inferior in transferring those rights. The terms of the agreements are therefore not comparable within the meaning of section 2703(b)(3).

On the basis of the foregoing, we do not think that petitioners have satisfied the final requirement of section 2703(b). *See Estate of Blount v. Commissioner*, T.C. Memo. 2004-116, slip op. at 48 (finding that solely testimony without production of comparable agreements was insufficient to satisfy section 2703(b)(3)), *aff'd in part, rev'd in part and remanded*, 428 F.3d 1338 (11th Cir. 2005). Section 2703(b) is therefore not satisfied, and so the RTP agreements must be disregarded

> for purposes of valuing the Dukes shares that Chet purchased in 2007. *See* § 2703(a).

The taxpayers avoided penalties because they relied on tax experts. However, the court found that the "goodwill" in a sale of the business to a third party was not entirely Chet's goodwill but the businesses, as the taxpayers reported.

3. <u>GRATs and Notes</u>. A petition has been filed in Tax Court on behalf of Charles and Patricia Elcan. The amount at issue is significant. The Elcans created near zeroed-out GRATs in 2018. A few months later, they bought the closely-held assets back for notes. Thereafter, the annuity payments were made by forgiving interest and principal on the notes. Neither the Notices of Deficiency issued after the gift tax audit, nor the Answer to the Petition, set forth any substantive objections by the government. Presumably it wants to argue that this arrangement is in sum and substance close enough to the trustee issuing a note in payment of an annuity to violate the 2000 2702 regulations which states:

> Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount does not constitute payment of the annuity amount.

Treas. Reg. § 25.2702-3

In addition, Treas. Reg. § 25.2702-3(d)(6) sets forth the following governing instrument requirement:

> In the case of a trust created on or after September 20, 1999, the trust instrument must prohibit the trustee from issuing a note, other debt instrument, option, or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation.

Why a note from the annuitant is equivalent to an annuity from the trust/trustee is unclear.

The petition also argues that the debt instrument prohibition is not within the scope of section 2702 at all and is thus invalid.

R. <u>SECTION 6166 — EXTENSION OF TIME TO PAY TAX</u>

S. <u>TAX ADMINISTRATION</u>

1. <u>The Regulatory Process</u>. Various aspects of the tax regulatory process have been attacked in the last few years resulting in sufficient taxpayer wins to alter the procedures used by the IRS and Treasury. For many years an open issue was whether tax regulations were to be reviewed by the judiciary using different standards than for other administrative regulations. The Supreme Court rejected that view in <u>Mayo Foundation v. U.S.</u>, 562 U.S. 44 (2011).

The IRS often prefers to issue notices dealing with problematic tax transactions because a notice need not be subject to "notice and comment." Taxpayers have challenged notices for that very reason and in <u>Mann Construction,</u>

Inc. v. United States, 27 F.4th 1138 (6th Cir. 2022), and Green Valley Investors, LLC, et al. v. Commissioner, 159 T.C. No. 5 (2022), won. A result has been that the IRS has issued regulations prohibiting certain kinds of conservation easement transactions (see discussion in these materials under that section).

When Treasury Regulations are issued for notice and comment, taxpayers may challenge whether the comments were reviewed and responded to. Again, in the conservation easement area, taxpayers have been successful in the 11th Circuit and the Tax Court in having regulations declared invalid. For example, see the discussion of Valley Park Ranch v. Commissioner, 162 T.C. No. 6 (2024) (in these materials in the conservation easement section).

Taxpayers may also challenge whether regulations, and potentially other guidance, is appropriate in light of the section(s) of the Internal Revenue Code with which the guidance deals. The Supreme Court dealt with that issue this term.

Section 7805 of the Code gives Treasury and the IRS general regulatory authority and Congress may also specifically authorize regulations to be issued. The former are referred to as "interpretive regulations," and the latter are referred to as "legislative regulations." The Internal Revenue Manual, describes the difference as follows:

> 32.1.1.2.8 (08-02-2018)
>
> How to Determine If a Rule Is Interpretative or Legislative
>
> Whether a regulation is promulgated under a specific grant of authority in the Internal Revenue Code does not govern whether the regulation is interpretative or legislative.
>
> If Congress simply provided an end result, without any guidance as to how to achieve the desired result, then regulations promulgated to achieve that result are considered to be legislative.
>
> If Congress provided specific rules and merely left gaps for the Secretary to fill, regulations filling those gaps are considered interpretative.
>
> If the regulation repeats law subsumed in the underlying legislation, then the regulation is considered interpretative.

A thorough description of the difficulties in determining which kind of regulation one is, and whether it matters, is set forth in Richman and Cranor, "Legislative and Interpretive Tax Rules and Rulemaking," 178 Tax Notes Federal 1149 (February 20, 2023).

Legislative regulations are given the highest level of deference by the courts, traditionally reviewed under an arbitrary and capricious standard. Interpretive regulations have been reviewed under Chevron deference since 1984. This term, the Supreme Court overruled Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc., 467 U. S. 837 (1984), in Loper Bright v. Raimondo, ____________ (S. Ct. 2024) with the Chief Justice writing for a majority joined by Justices Thomas, Alito, Gorsuch, Kavanaugh, and Barrett. Justices Thomas and Gorsuch also joined a concurrence, and Justice Kagan filed a dissent joined by Justices Sotomayor and Jackson (there were actually two cases consolidated into one opinion and Justice Jackson recused herself from one of the two cases). Loper Bright retained the requirement of a high level of deference where Congress has specifically delegated writing regulations to an agency. However, with respect to the level of deference the judiciary should give to interpretive regulations, Loper Bright holds that only if the agency's interpretation is persuasive should the interpretation hold sway. That is commonly called Skidmore deference which the Loper Bright majority describes as follows:

> Perhaps most notably along those lines, in Skidmore v. Swift & Co., 323 U. S. 134 (1944), the Court explained that the "interpretations and opinions" of the relevant agency, "made in pursuance of official duty" and "based upon . . . specialized experience," "constitute[d] a body of experience and informed judgment to which courts and litigants [could] properly resort for guidance," even on legal questions. Id., at 139–140. "The weight of such a judgment in a particular case," the Court observed, would "depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." Id., at 140.

Skidmore deference is what the judiciary applies to review other guidance (e.g. revenue rulings) from the IRS and Treasury.

The majority's discussion of judicial review of agency decisions and actual application of Chevron is obviously important and as follows:

> Beginning with expertise, we recently noted that interpretive issues arising in connection with a regulatory scheme often "may fall more naturally into a judge's bailiwick" than an agency's. *Kisor*, 588 U. S., at 578 (opinion of the Court). We thus observed that "[w]hen the agency has no comparative expertise in resolving a regulatory ambiguity, Congress presumably would not grant it that authority." *Ibid*. *Chevron*'s broad rule of deference, though, demands that courts presume just the opposite. Under that rule, ambiguities of all stripes trigger deference. Indeed, the Government and, seemingly, the dissent continue to defend the proposition that *Chevron* applies even in cases having little to do with an agency's technical subject matter expertise. See Brief for Respondents in No. 22–1219, p. 17; *post*, at 10.
>
> But even when an ambiguity happens to implicate a technical matter, it does not follow that Congress has taken the power to authoritatively interpret the statute from the courts and given it to the agency. Congress expects courts to handle technical statutory questions. "[M]any statutory cases" call upon "courts [to] interpret the mass of technical detail that is the ordinary diet of the law," *Egelhoff v. Egelhoff*, 532 U. S. 141, 161 (2001) (Breyer, J., dissenting), and courts did so without issue in agency cases before *Chevron*, see *post*, at 30 (GORSUCH, J., concurring). Courts, after all, do not decide such questions blindly. The parties and Cite as: 603 U. S. ____ (2024) Opinion of the Court 25 amici in such cases are steeped in the subject matter, and reviewing courts have the benefit of their perspectives. In an agency case in particular, the court will go about its task with the agency's "body of experience and informed judgment," among other information, at its disposal. *Skidmore*, 323 U. S., at 140. And although an agency's interpretation of a statute "cannot bind a court," it may be especially informative "to the extent it rests on factual premises within [the agency's] expertise." *Bureau of Alcohol, Tobacco and Firearms v. FLRA*, 464 U. S. 89, 98,

n. 8 (1983). Such expertise has always been one of the factors which may give an Executive Branch interpretation particular "power to persuade, if lacking power to control." *Skidmore*, 323 U. S., at 140; see, e.g., *County of Maui v. Hawaii Wildlife Fund*, 590 U. S. 165, 180 (2020); Moore, 95 U. S., at 763.

For those reasons, delegating ultimate interpretive authority to agencies is simply not necessary to ensure that the resolution of statutory ambiguities is well informed by subject matter expertise. The better presumption is therefore that Congress expects courts to do their ordinary job of interpreting statutes, with due respect for the views of the Executive Branch. And to the extent that Congress and the Executive Branch may disagree with how the courts have performed that job in a particular case, they are of course always free to act by revising the statute.

Nor does a desire for the uniform construction of federal law justify *Chevron*. Given inconsistencies in how judges apply *Chevron*, see *infra*, at 30–33, it is unclear how much the doctrine as a whole (as opposed to its highly deferential second step) actually promotes such uniformity. In any event, there is little value in imposing a uniform interpretation of a statute if that interpretation is wrong. We see no reason to presume that Congress prefers uniformity for uniformity's sake over the correct interpretation of the laws it enacts.

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That is not to say that Congress cannot or does not confer discretionary authority on agencies. Congress may do so, subject to constitutional limits, and it often has. But to stay out of discretionary policymaking left to the political branches, judges need only fulfill their obligations under the APA to independently identify and respect such delegations of authority, police the outer statutory boundaries of those delegations, and ensure that agencies exercise their discretion consistent with the APA. By forcing courts to instead pretend that ambiguities are necessarily delegations, *Chevron* does not prevent judges from making policy. It prevents them from judging.

In truth, *Chevron*'s justifying presumption is, as Members of this Court have often recognized, a fiction. See *Buffington v. McDonough*, 598 U. S. ___, ___ (2022) (GORSUCH, Cite as: 603 U. S. ____ (2024) Opinion of the Court 27 J., dissenting from denial of certiorari) (slip op., at 11); *Cuozzo*, 579 U. S., at 286 (THOMAS, J., concurring); Scalia, 1989 Duke L. J., at 517; see also post, at 15 (opinion of KAGAN, J.). So we have spent the better part of four decades imposing one limitation on *Chevron* after another, pruning its presumption on the understanding that "where it is in doubt that Congress actually intended to delegate particular interpretive authority to an agency, *Chevron* is 'inapplicable.'" *United States v. Mead Corp.*, 533 U. S. 218, 230 (2001) (quoting *Christensen v. Harris County*, 529 U. S. 576, 597 (2000) (Breyer, J., dissenting)); see also *Adams Fruit Co. v. Barrett*, 494 U. S. 638, 649 (1990).

Consider the many refinements we have made in an effort to match *Chevron*'s presumption to reality. We have said that *Chevron* applies only "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Mead*, 533 U. S., at 226–227. In practice, that threshold requirement—sometimes called *Chevron* "step zero"—largely limits *Chevron* to "the fruits of notice-and-comment rulemaking or formal adjudication." 533 U. S., at 230. But even when those processes are used, deference is still not warranted "where the regulation is 'procedurally defective'—that is, where the agency errs by failing to follow the correct procedures in issuing the regulation." *Encino Motorcars, LLC v. Navarro*, 579 U. S. 211, 220 (2016) (quoting *Mead*, 533 U. S., at 227).

Even where those procedural hurdles are cleared, substantive ones remain. Most notably, *Chevron* does not apply if the question at issue is one of "deep 'economic and political significance.'" *King v. Burwell*, 576 U. S. 473, 486 (2015). We have instead expected Congress to delegate such authority "expressly" if at all, *ibid*., for "[e]xtraordinary grants of regulatory authority are rarely accomplished through 'modest words,' 'vague terms,' or 'subtle device[s],'" *West Virginia v. EPA*, 597 U. S. 697, 723 (2022) (quoting *Whitman v. American Trucking Assns., Inc.*, 531 U. S. 457, 468 (2001); alteration in original). Nor have we applied *Chevron* to agency interpretations of judicial review provisions, see *Adams Fruit Co*., 494 U. S., at 649–650, or to statutory schemes not administered by the agency seeking deference, see *Epic Systems Corp. v. Lewis*, 584 U. S. 497, 519– 520 (2018). And we have sent mixed signals on whether *Chevron* applies when a statute has criminal applications. Compare *Abramski v. United States*, 573 U. S. 169, 191 (2014), with *Babbitt v. Sweet Home Chapter, Communities for Great Ore*., 515 U. S. 687, 704, n. 18 (1995).

Confronted with this byzantine set of preconditions and exceptions, some courts have simply bypassed *Chevron*, saying it makes no difference for one reason or another. (Fn7) And even when they do invoke *Chevron*, courts do not always heed the various steps and nuances of that evolving doctrine. In one of the cases before us today, for example, the First Circuit both skipped "step zero," see 62 F. 4th, at 628, and refused to "classify [its] conclusion as a product of *Chevron* step one or step two"—though it ultimately appears to have deferred under step two, *id*., at 634.

This Court, for its part, has not deferred to an agency interpretation under *Chevron* since 2016. See *Cuozzo*, 579 U. S., at 280 (most recent occasion). But *Chevron* remains on the books. So litigants must continue to wrestle with it, and lower courts—bound by even our crumbling precedents, see *Agostini v. Felton*, 521 U. S. 203, 238 (1997)— understandably continue to apply it.

The experience of the last 40 years has thus done little to rehabilitate *Chevron*. It has only made clear that *Chevron*'s fictional presumption of congressional intent was always unmoored from the APA's demand that courts exercise independent judgment in construing statutes administered by agencies. At best, our intricate *Chevron* doctrine has been nothing more than a distraction from the question that matters: Does the statute authorize the challenged agency action? And at worst, it has required courts to violate the APA by yielding to an agency the express responsibility, vested in "the reviewing *court*," to "decide all relevant questions of law" and "interpret . . . statutory provisions." §706 (emphasis added).

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Rather than safeguarding reliance interests, *Chevron* affirmatively destroys them. Under *Chevron*, a statutory ambiguity, no matter why it is there, becomes a license authorizing an agency to change positions as much as it likes, with "[u]nexplained inconsistency" being "at most . . . a reason for holding an interpretation to be . . . arbitrary and capricious." *Brand X*, 545 U. S., at 981. But statutory ambiguity, as we have explained, is not a reliable indicator of actual delegation of discretionary authority to agencies. *Chevron* thus allows agencies to change course even when Congress has given them no power to do so. By its sheer breadth, *Chevron* fosters unwarranted instability in the law, leaving those attempting to plan around agency action in an eternal fog of uncertainty.

> *Chevron* accordingly has undermined the very "rule of law" values that stare decisis exists to secure. *Michigan v. Bay Mills Indian Community,* 572 U. S. 782, 798 (2014). And it cannot be constrained by admonishing courts to be extra careful, or by tacking on a new batch of conditions. We would need to once again "revis[e] its theoretical basis . . . in order to cure its practical deficiencies." *Montejo v. Louisiana*, 556 U. S. 778, 792 (2009). *Stare decisis* does not require us to do so, especially because any refinements we might make would only point courts back to their duties under the APA to "decide all relevant questions of law" and "interpret . . . statutory provisions." §706. Nor is there any reason to wait helplessly for Congress to correct our mistake. The Court has jettisoned many precedents that Congress likewise could have legislatively overruled. *See, e.g., Patterson v. McLean Credit Union*, 485 U. S. 617, 618 (1988) (*per curiam*) (collecting cases). And part of "judicial humility," *post*, at 3, 25 (opinion of KAGAN, J.,), is admitting and in certain cases correcting our own mistakes, especially when those mistakes are serious, see *post*, at 8–9 (opinion of GORSUCH, J.).
>
> This is one of those cases. *Chevron* was a judicial invention that required judges to disregard their statutory duties. And the only way to "ensure that the law will not merely change erratically, but will develop in a principled and intelligible fashion," *Vasquez v. Hillery*, 474 U. S. 254, 265 (1986), is for us to leave *Chevron* behind.
>
> By doing so, however, we do not call into question prior cases that relied on the *Chevron* framework. The holdings of those cases that specific agency actions are lawful—including the Clean Air Act holding of *Chevron* itself—are still subject to statutory *stare decisis* despite our change in interpretive methodology. *See CBOCS West, Inc. v. Humphries*, 553 U. S. 442, 457 (2008). Mere reliance on *Chevron* cannot constitute a "'special justification'" for overruling such a holding, because to say a precedent relied on *Chevron* is, at best, "just an argument that the precedent was wrongly decided." *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U. S. 258, 266 (2014) (quoting *Dickerson v. United States*, 530 U. S. 428, 443 (2000)). That is not enough to justify overruling a statutory precedent. (footnotes omitted)

The majority's decision rests on the Administrative Procedures Act which it concludes is simply irreconcilable with Chevron:

> In a statute designed to "serve as the fundamental charter of the administrative state," *Kisor v. Wilkie*, 588 U. S. 558, 580 (2019) (plurality opinion) (internal quotation marks omitted), Congress surely would have articulated a similarly deferential standard applicable to questions of law had it intended to depart from the settled pre-APA understanding that deciding such questions was "exclusively a judicial function," *American Trucking Assns*., 310 U. S., at 544. But nothing in the APA hints at such a dramatic departure. On the contrary, by directing courts to "interpret constitutional and statutory provisions" without differentiating between the two, Section 706 makes clear that Cite as: 603 U. S. ____ (2024) Opinion of the Court 15 agency interpretations of statutes—like agency interpretations of the Constitution—are not entitled to deference. Under the APA, it thus "remains the responsibility of the court to decide whether the law means what the agency says." *Perez v. Mortgage Bankers Assn*., 575 U. S. 92, 109 (2015) (Scalia, J., concurring in judgment).4

The concurrence by Justices Gorsuch and Thomas would have rejected Chevron separation of powers grounds, and argues that it was an experiment in any event. They write:

> If *Chevron* meant to usher in a revolution in how judges interpret laws, no one appears to have realized it at the time. *Chevron*'s author, Justice Stevens, characterized the decision as a "simpl[e] . . . restatement of existing law, nothing more or less." Merrill 255, 275. In the "19 argued cases" in the following Term "that presented some kind of question about whether the Court should defer to an agency interpretation of statutory law," this Court cited *Chevron* just once. Merrill 276. By some accounts, the decision seemed "destined to obscurity." *Ibid*.
>
> It was only three years later when Justice Scalia wrote a concurrence that a revolution began to take shape. *Buffington*, 598 U. S., at ___ (slip op., at 8). There, he argued for a new rule requiring courts to defer to executive agency interpretations of the law whenever a "'statute is silent or ambiguous.'" *NLRB v. Food & Commercial Workers*, 484 U. S. 112, 133–134 (1987) (opinion of Scalia, J.). Eventually, a majority of the Court followed his lead. *Buffington*, 598 U. S., at ___ (slip op., at 8). But from the start, Justice Scalia made no secret about the scope of his ambitions. See Judicial Deference to Administrative Interpretations of Law, 1989 Duke L. J. 511, 521 (1989) (Scalia). The rule he advocated for represented such a sharp break from prior practice, he explained, that many judges of his day didn't yet "understand" the "old criteria" were "no longer relevant." *Ibid.* Still, he said, overthrowing the past was worth it because a new deferential rule would be "easier to follow." *Ibid*.
>
> Events proved otherwise. As the years wore on and the Court's new and aggressive reading of *Chevron* gradually exposed itself as unworkable, unfair, and at odds with our separation of powers, Justice Scalia could have doubled down on the project. But he didn't. He appreciated that Cite as: 603 U. S. ____ (2024) GORSUCH, J., concurring 29 *stare decisis* is not a rule of "if I thought it yesterday, I must think it tomorrow." And rather than cling to the pride of personal precedent, the Justice began to express doubts over the very project that he had worked to build. See *Perez v. Mortgage Bankers Assn*., 575 U. S. 92, 109–110 (2015) (opinion concurring in judgment); cf. *Decker v. Northwest Environmental Defense Center*, 568 U. S. 597, 617–618, 621 (2013) (opinion concurring in part and dissenting in part). If *Chevron*'s ascent is a testament to the Justice's ingenuity, its demise is an even greater tribute to his humility.

Footnote 6 states:

> It should be recalled that, when Justice Scalia launched the *Chevron* revolution, there were many judges who "abhor[red] . . . 'plain meaning' " and preferred instead to elevate "legislative history" and their own curated accounts of a law's "purpose[s]" over enacted statutory text. Scalia 515, 521. *Chevron*, he predicted, would provide a new guardrail against that practice. Scalia 515, 521. As the Justice's later writings show, he had the right diagnosis, just the wrong cure. The answer for judges eliding statutory terms is not deference to agencies that may seek to do the same, but a demand that all return to a more faithful adherence to the written law. That was, of course, another project Justice Scalia championed. And as we like to say, "we're all textualists now."

The dissent simply thinks the majority is wrong-headed. Justice Kagan writes:

> For 40 years, *Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837 (1984), has served as a cornerstone of administrative law, allocating responsibility for statutory construction between courts and agencies. Under *Chevron*, a court uses all its normal interpretive tools to determine whether Congress has spoken to an issue. If the court finds Congress has done so, that is the end of the matter; the agency's views make no difference. But if the court finds, at the end of its interpretive work, that Congress has left an ambiguity or gap, then a choice must be made. Who should give content to a statute when Congress's instructions have run out? Should it be a court? Or should it be the agency Congress has charged with administering the statute? The answer *Chevron* gives is that it should usually be the agency, within the bounds of reasonableness. That rule has formed the backdrop against which Congress, courts, and agencies—as well as regulated parties and the public—all have operated for decades. It has been applied in thousands of judicial decisions. It has become part of the warp and woof of modern government, supporting regulatory efforts of all kinds—to name a few, keeping air and water clean, food and drugs safe, and financial markets honest.
>
> And the rule is right. This Court has long understood *Chevron* deference to reflect what Congress would want, and so to be rooted in a presumption of legislative intent. Congress knows that it does not—in fact cannot—write perfectly complete regulatory statutes. It knows that those statutes will inevitably contain ambiguities that some other actor will have to resolve, and gaps that some other actor will have to fill. And it would usually prefer that actor to be the responsible agency, not a court. Some interpretive issues arising in the regulatory context involve scientific or technical subject matter. Agencies have expertise in those areas; courts do not. Some demand a detailed understanding of complex and interdependent regulatory programs. Agencies know those programs inside-out; again, courts do not. And some present policy choices, including trade-offs between competing goods. Agencies report to a President, who in turn answers to the public for his policy calls; courts have no such accountability and no proper basis for making policy. And of course Congress has conferred on that expert, experienced, and politically accountable agency the authority to administer—to make rules about and otherwise implement—the statute giving rise to the ambiguity or gap. Put all that together and deference to the agency is the almost obvious choice, based on an implicit congressional delegation of interpretive authority. We defer, the Court has explained, "because of a presumption that Congress" would have "desired the agency (rather than the courts)" to exercise "whatever degree of discretion" the statute allows. *Smiley v. Citibank (South Dakota)*, N. A., 517 U. S. 735, 740–741 (1996).
>
> Today, the Court flips the script: It is now "the courts (rather than the agency)" that will wield power when Congress has left an area of interpretive discretion. A rule of judicial humility gives way to a rule of judicial hubris. In recent years, this Court has too often taken for itself decision-making authority Congress assigned to agencies. The Court has substituted its own judgment on workplace health for that of the Occupational Safety and Health Administration; its own judgment on climate change for that of the Environmental Protection Agency; and its own judgment on student loans for that of the Department of Education. *See, e.g., National Federation of Independent Business v. OSHA*, 595 U. S. 109 (2022); *West Virginia v. EPA*, 597 U. S. 697 (2022); *Biden v. Nebraska*, 600 U. S. 477 (2023). But evidently that was, for this Court, all too piecemeal. In one fell swoop, the majority today gives itself exclusive power over every open issue—

> no matter how expertise-driven or policy-laden—involving the meaning of regulatory law. As if it did not have enough on its plate, the majority turns itself into the country's administrative czar. It defends that move as one (suddenly) required by the (nearly 80-year-old) Administrative Procedure Act. But the Act makes no such demand. Today's decision is not one Congress directed. It is entirely the majority's choice.
>
> And the majority cannot destroy one doctrine of judicial humility without making a laughing-stock of a second. (If opinions had titles, a good candidate for today's would be Hubris Squared.) *Stare decisis* is, among other things, a way to remind judges that wisdom often lies in what prior judges have done. It is a brake on the urge to convert "every new judge's opinion" into a new legal rule or regime. *Dobbs v. Jackson Women's Health Organization*, 597 U. S. 215, 388 (2022) (joint opinion of Breyer, SOTOMAYOR, and KAGAN, JJ., dissenting) (quoting 1 W. Blackstone, Commentaries on the Laws of England 69 (7th ed. 1775)). *Chevron* is entrenched precedent, entitled to the protection of stare decisis, as even the majority acknowledges. In fact, *Chevron* is entitled to the supercharged version of that doctrine because Congress could always overrule the decision, and because so many governmental and private actors have relied on it for so long. Because that is so, the majority needs a "particularly special justification" for its action. *Kisor v. Wilkie*, 588 U. S. 558, 588 (2019) (opinion of the Court). But the majority has nothing that would qualify. It barely tries to advance the usual factors this Court invokes for overruling precedent. Its justification comes down, in the end, to this: Courts must have more say over regulation—over the provision of health care, the protection of the environment, the safety of consumer products, the efficacy of transportation systems, and so on. A longstanding precedent at the crux of administrative governance thus falls victim to a bald assertion of judicial authority. The majority disdains restraint, and grasps for power.

In a post-Chevron world, an interesting question is whether Treasury will decide to do more rule-making through revenue rulings and other such guidance rather than regulations if the same level of deference is given to each. Presumably the opportunity for taxpayers, and interest groups, to comment on regulations, and any changes made in response, could help demonstrate reasonableness and persuasiveness of the regulations. Of course, the government could decide not to issue guidance in more areas and simply audit and litigate.

In Corner Post, Inc. v. Board of Governors of the Federal Reserve System, ________________ (St. Ct. 2024), the Supreme Court allowed a truck stop and convenience store in North Dakota that opened in 2018 to challenge a 2011 Federal Reserve regulation dealing with credit card fees because the harm to Corner Post was within the general six year statute of limitations. The government had argued that the statute began to run back in 2011. Justice Barret wrote for the majority with the Chief Justice and Justices Thomas, Alito, Gorsuch, and Kavanaugh (who wrote a concurring opinion); Justice Jackson wrote a dissent joined by Justices Sotomayor and Kagan. Corner Post's claim was under the Administrative Procedures Act which does not govern many tax regulations, at least in the eyes of the IRS and Treasury (e.g. T. D. 9869, dealing with self-employment tax in disregarded entities, which notes "section 553(b) of the Administrative Procedures Act (5 U. S. C. chapter 5) does not apply to these regulations"), a claim that taxpayers may be expected to challenge going forward. where older regulations are being challenged.

An early post-Loper Bright decision is Varian Medical Systems v. Commissioner, 163 T.C. No. 4 (2024) dealing with the effective date of certain 2017 changes to the dividend received deduction and a foreign tax credit:

> Congress enacted the TCJA in 2017. Among other things, the TCJA added to the Code new section 245A, which allows a domestic corporation a deduction for certain dividends received from foreign subsidiaries. Section 245A applies to "distributions made after ... December 31, 2017." TCJA § 14101(f), 131 Stat. at 2192.
>
> Because the deduction under section 245A applies to dividends received by a domestic corporation from a foreign corporation, it had the potential to interact with existing section 78. As in effect before the adoption of the TCJA, that section provided that, for taxpayers who claimed foreign tax credits, a specified amount "shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation."
>
> Recognizing that section 245A might otherwise allow a taxpayer who claims foreign tax credits to deduct a dividend that section 78 would have deemed the taxpayer to receive, the TCJA amended section 78 to preclude that result. But, instead of using the same effective date that it applied to section 245A, the TCJA amended section 78 for "taxable years of foreign corporations beginning after December 31, 2017, and ... taxable years of United States shareholders in which or with which such taxable years of foreign corporations end." TCJA § 14301(d), 131 Stat. at 2225.
>
> For some taxpayers—including those with foreign subsidiaries with fiscal years (that is, foreign subsidiaries whose taxable years do not run from January 1 to December 31 of each year)—this effective date mismatch created a window during which section 245A was in effect, but the amendments to section 78 were not. The question before us is whether, during that window, section 245A provided one such taxpayer, Varian Medical Systems, Inc. (Varian), a deduction for a dividend that it was deemed to receive under section 78.

The court found that the statute was plain on its face and a contrary regulation was invalid. The opinion states:

> Finally, the Commissioner argues that Varian's "position is illogical in treating its subpart F income as ineligible for the Section 245A DRD but the Section 78 gross-up arising from that inclusion as qualifying, even though the latter is the tax expense that was incurred on subpart F income." Resp't's Br. 23 n.10. We struggle to see why Varian's position is illogical. As a general matter, subpart F income is not a dividend; rather it is simply an inclusion in gross income. *See Rodriguez v. Commissioner*, 137 T.C. 174, 177–78 (2011), *aff'd*, 722 F.3d 306 (5th Cir. 2013). Therefore, subpart F income does not qualify for a deduction under the terms of section 245A. But, as we have already discussed, section 78 expressly deems Varian to receive a dividend, which does qualify for the deduction. So, at bottom, the Commissioner's problem lies with the text of the statute, not Varian's position.
>
> **4.** ***Amended Treasury Regulation § 1.78-1***
>
> Finally, the Commissioner argues that Treasury Regulation § 1.78-1, as revised June 21, 2019, precludes Varian from deducting its section 78 dividend. In

relevant part, the second sentence of Treasury Regulation § 1.78-1(a) (as amended in 2019) says:

> A section 78 dividend is treated as a dividend for all purposes of the Code, except that it is not treated as a dividend for purposes of section 245 or 245A, and does not increase the earnings and profits of the domestic corporation or decrease the earnings and profits of the foreign corporation.

Subsection (c) then applies this sentence (and this sentence only) "to section 78 dividends that are received after December 31, 2017, by reason of taxes deemed paid under section 960(a) with respect to a taxable year of a foreign corporation beginning before January 1, 2018."

The rule adopted by the revised regulations essentially gives one of the TCJA's amendments to section 78 an earlier effective date than provided for in the TCJA to prevent taxpayers like Varian from deducting section 78 dividends. But, as we have already observed, the plain text of the statutes provides for the deduction.22 As the Supreme Court has said, "self-serving regulations never 'justify departing from the statute's clear text.' " *Niz-Chavez v. Garland*, 141 S. Ct. 1474, 1485 (2021) (quoting *Pereira v. Sessions*, 138 S. Ct. 2105, 2118 (2018)); *see also Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 328 (2014) ("[T]he need to rewrite clear provisions of the statute should have alerted [the Government] that it had taken a wrong interpretive turn."); *Koshland v. Helvering*, 298 U.S. 441, 447 (1936) ("[W]here ... the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation."); *Abdo v. Commissioner*, No. 5514-20, 162 T.C., slip op. at 21 (Apr. 2, 2024) (reviewed) ("Respondent's regulation ... cannot change the result dictated by an unambiguous statute." (citing *Niz-Chavez*, 141 S. Ct. at 1485)).

The Commissioner initially argued that, even if we disagreed with his interpretation of the statute, the statute was at least ambiguous and that, under *Chevron,* we had to accept his regulation's attempt to fill the gap because his interpretation was permissible. But of course *Chevron* has now been overruled. *See Loper Bright*, 144 S. Ct. at 2273. A "permissible" interpretation of a statute no longer prevails simply because an agency offers it to resolve a perceived ambiguity. *See id.* at 2266, 2273.

As the Supreme Court observed in *Loper Bright*, "statutes, no matter how impenetrable, do—in fact, must—have a single, best meaning. That is the whole point of having written statutes; 'every statute's meaning is fixed at the time of enactment.' " *Id.* at 2266 (quoting *Wis. Cent. Ltd. v. United States*, 585 U.S. 274, 284 (2018)). And, in cases involving ambiguity, "instead of declaring a particular party's reading 'permissible' ..., courts [must] use every tool at their disposal to determine the best reading of the statute and resolve the ambiguity." *Id.* Put another way, "in an agency case as in any other ... even if some judges might (or might not) consider the statute ambiguous, there is a best reading all the same—the reading the court would have reached if no agency were involved." *Id.* (cleaned up).

In short, "[i]n the business of statutory interpretation, if it is not the best, it is not permissible." *Id.* And, as we have shown above, the best (indeed the unambiguous) reading of the provisions at issue here permits Varian's deduction.

Footnote 22 states:

> 22 In the preamble to the final regulation, Treasury acknowledged that the rule was "necessary to ensure that th[e] principle [that a section 78 dividend is not eligible for a deduction under section 245A] is consistently applied with respect to a CFC that uses a fiscal year beginning in 2017 ... in order to prevent the arbitrary disparate treatment of similarly situated taxpayers." T.D. 9866, 2019-29 I.R.B. 261, 296, 84 Fed. Reg. 29,288, 29,319 (June 21, 2019). Treasury said that, without the rule in the revised regulation, "a U.S. shareholder of a fiscal year CFC would effectively be able to take both a credit and a deduction for foreign taxes by claiming a section 245A deduction with respect to its section 78 dividend." *Id.* A fair reading of this preamble is that Treasury thought the plain statutory text provided (or could be read as providing) for the deduction Varian claims, as we find here.

2. **<u>2024 Priority Guidance Plan</u>**. October 3, 2024 (2024-2025).

EXEMPT ORGANIZATIONS

* * *

5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

6. Regulations under §4966 regarding donor advised funds, including excise taxes on sponsoring organizations and fund management. Proposed regulations published November 14, 2023.

7. Regulations under §4967 regarding prohibited benefits, including excise taxes on donors, donor advisors, related persons, and fund management.

8. Regulations under §4958 regarding donor advised funds and supporting organizations.

9. Guidance regarding the public-support computation with respect to distributions from donor advised funds.

GENERAL TAX ISSUES

* * *

17.Guidance under §164 on applying the state and local tax deduction cap.

18. Guidance under §170 regarding charitable contributions.

19. Guidance under §170 regarding conservation easements, including facade easements.

GIFTS AND ESTATES AND TRUSTS

1. Regulations under §645 pertaining to the duration of an election to treat certain revocable trusts as part of an estate.

2. Final regulations under §§1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

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

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

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

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

* * *

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

9. Regulations under §2642 regarding the redetermination of the inclusion ratio on the sale of an interest in a trust for GST purposes. [This is new.]

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

11. Final regulations under §6011 identifying a transaction involving certain uses of charitable remainder annuity trusts as a listed transaction. Proposed regulations were issued on March 22, 2024.

12. Guidance updating the user fee for estate tax closing letters.

3. **<u>No Ruling Positions</u>**. In Rev. Proc. 2025-3 the IRS set forth issues on which it will not rule in Section 3. Among those are:

* * *

(18) Section 101. —Certain Death Benefits.—Whether there has been a transfer for value for purposes of § 101(a) in situations involving a grantor and a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

* * *

(38) Section 170.—Charitable. Etc., Contributions and Gifts.—Whether a charitable contribution deduction under § 170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 170(c).

(39) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

* * *

(79) Sections 507, 664, 4941, and 4945.—Termination of Private Foundation Status; Charitable Remainder Trusts; Taxes on Self-Dealing; Taxes on Taxable Expenditures.—Issues pertaining to the tax consequences of the termination of a charitable remainder trust (as defined in § 664) before the end of the trust term as defined in the trust's governing instrument in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets.

* * *

(81) Sections 511, 512, 513, and 514. – Imposition of Tax on Unrelated Business Income of Charitable, Etc., Organizations; Unrelated Business Taxable Income; Unrelated Trade or Business; Unrelated Debt-Financed Income. – Whether unrelated business income tax issues arise when charitable lead trust assets are invested with charitable organizations.

* * *

(85) Section 641. —Imposition of Tax. —Whether the period of administration or settlement of an estate or a trust (other than a trust described in §664) is reasonable or unduly prolonged.

(86) Section 642(c). —Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose. —Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

(87) Section 643(f).—Treatment of multiple trusts.—Whether two or more trusts shall be treated as one trust for purposes of subchapter J of chapter 1.

(88) Section 664. —Charitable Remainder Trusts. —Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.

* * *

(90) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

* * *

(95) Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.

* * *

(101) Section 1221.—Capital Asset Defined.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or exchange of a capital asset by the beneficiaries.

* * *

(110) Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a charitable contribution deduction under § 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2055(a).

* * *

(112) Section 2522.—Charitable and Similar Gifts.—Whether a charitable contribution deduction under § 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2522(a).

(113) Section 2601.—Tax Imposed.— Whether a trust exempt from generation-skipping transfer (GST) tax under § 26.260l — l(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status

when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1 (b)(4)(i)(E).

* * *

(125) Section 4941.—Taxes on Self- Dealing.—Whether transactions during the administration of an estate or trust meet the requirements of the exception to § 4941 set forth in § 53.4941(d)-1(b)(3) of the Private Foundation Excise Tax Regulations, in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

(126) Section 4941.—Taxes on Self-Dealing.—Whether an act of self-dealing occurs when a private foundation (or other entity subject to § 4941) owns or receives an interest in a limited liability company or other entity that owns a promissory note issued by a disqualified person.

* * *

(130) Section 4958.—Taxes on Excess Benefit Transactions.—Whether a compensation or property transaction satisfies the rebuttable presumption that the transaction is not an excess benefit transaction as described in § 53.4958-6 of the Excess Benefit Transactions Excise Tax Regulations.

In addition, rulings will "not ordinarily" be issued on the issues below, under Section 4. "Not ordinarily" means that unique and compelling reasons must be demonstrated in order for a ruling to be issued.

* * *

(18) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

* * *

(38) Section 664.—Charitable Remainder Trusts.—Whether a trust that will calculate the unitrust amount under § 664(d)(3) qualifies as a § 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under § 643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

* * *

(41) Section 678.—Person Other than Grantor Treated as Substantial Owner.—Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a

note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

* * *

(49) Sections 2035, 2036, 2037, 2038, and 2042.—Adjustments for Certain Gifts Made Within Three Years of Decedent's Death; Transfers with Retained Life Estate; Transfers Taking Effect at Death; Revocable Transfers; Proceeds of Life Insurance.—Whether trust assets are includible in a trust beneficiary's gross estate under § 2035, 2036. 2037, 2038, or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within 3 years of selling such property to the trust, and (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

* * *

(52) Section 2501.—Imposition of Tax.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of § 2501 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(53) Section 2503.—Taxable Gifts.— Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(54) Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether § 2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

* * *

> (57) Section 2601.—Tax Imposed.— Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.
>
> (58) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether annuity interests are qualified annuity interests under § 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under § 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.
>
> (59) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether a trust with one term holder satisfies the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) to be a qualified personal residence trust.
>
> (60) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to § 2702 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Finally, rulings related to private trust companies, decanting, or the basis adjustment, if any, of assets owned by a grantor trust, will not be issued until the IRS resolves the issue through publication of a revenue ruling, revenue procedure, or regulations, under section 5. In addition, ING trusts continue in the "to be resolved" list not the "no ruling" list; INGs are described like this:

> (8) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a transfer in trust under §§ 673 to 677 that is purported to be an incomplete gift under § 2511, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.
>
> (9) Section 678.—Person other than Grantor Treated as Substantial Owner. — Whether the beneficiaries of a trust will be considered the owners of any portion of such trust when two or more of such beneficiaries have the power to distribute income or principal to themselves by unanimous consent.

* * *

(15) Sections 2041 and 2514.—Powers of Appointment—Whether the beneficiaries of a trust hold general powers of appointment over any portion of a transfer to a trust when (A) two or more of such beneficiaries have the power to distribute income or principal to themselves by unanimous consent and without the consent of the donor and either (B) such beneficiaries must be replaced upon the lapse of their powers as the result of death or otherwise or (C) all of such beneficiaries' powers described by (A) lapse upon the death of any one of the beneficiaries.

(17) Section 2511.—Transfers in General.—Whether a transfer in trust that is purported not to be considered owned by the grantor under § 671 is an incomplete gift, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.

4. **Form 709 Revision**. The Form 709 for 2023 has a new line 20 to be checked if a gift "or other transfer" is of a digital asset or interest in a digital asset.

5. **Specific Waiver of QTIP Reimbursement Required Under New York Law**. In Matter of Townson, 2025 N.Y. Slip Op. 25072, the question was whether the following tax apportionment clause waived QTIP reimbursement:

> "I direct that my Executor *pay out my residuary estate, without apportionment*, all estate inheritance and like taxes imposed by the government of the United States, or any state or territory thereof, or by any foreign government or political subdivision thereof, in respect to all property required to be included in my gross estate for estate or like tax purposes by any such governments, *whether the property passes under this Will or otherwise, without contribution by any recipient of any such property*"

(emphasis added).

The court held that "magic words" are required to waived QTIP reimbursement:

> In *Matter of Gordon* Surrogate Renee Roth, the (then and now) much-respected authority on all matters trust and estate, held, in a case of first impression following the passage of the federal Economic Recovery Act of 1986 that created marital deduction trusts, that a tax exoneration clause that did not specifically mention the QTIP trusts failed to exclude the trusts from their share of the estate tax burden. "The basis for requiring express mention of a QTIP trust is the presumption that most testators do not intend to apply a general tax exoneration clause to QTIP property" (*Matter of Estate of Gordon*, 134 Misc.2d 247, 252, 510 N.Y.S.2d 815 [Sur. Ct., New York County 1986]).
>
> She noted as well that the New York State Legislature had followed the lead of Congress and amended EPTL 2-1.8. "The recent amendment of EPTL 2—1.8 ... is a similar attempt to protect the testator's presumed intent and prevent inadvertent alterations of tax apportionment clauses" (*Matter of Gordon*, 134 Misc.2d at 252, 510 N.Y.S.2d 815).

In *Matter of Kramer*, the court, affirming a decision also by Surrogate Roth, declined to give effect to a tax exoneration clause because it failed to reference the QTIP trusts in question (*Matter of Kramer*, 203 A.D.2d 78, 79, 610 N.Y.S.2d 31 [1st Dept. 1994]).

The issue here then, is whether the language in Decedent's Will regarding tax apportionment is "specific" enough to comply with the statutory requirement of a specific direction found in EPTL § 2-1.8 (d-1) (1) (A), and a specific "indication of intent" (Internal Revenue Code § 2207A (a) (1).

It is not. Where a waiver of apportionment against a QTIP trust is sought, EPTL § 2-1.8(d-1) (1) (A) and Internal Revenue Code § 2207A (a) (2) govern the result and mandate strict compliance with the direction to "specifically direct otherwise."

The failure in a will or trust to specifically refer to the QTIP trusts (and/or the Code and/or EPTL sections) leaves the fiduciary of the estate the authority and the right - the entitlement, to use the statutory language - to seek contribution from the trusts for the payment of taxes. The language in decedent Ann Townson's Will is "one of the formbook examples of tax exoneration clauses that evolved before there were QTIPs. The post-ERTA draftsman, on the other hand, is advised to use totally different language to apportion QTIP taxes" (*Matter of Gordon*, 134 Misc.2d at 252, 510 N.Y.S.2d 815).

Where the will or trust lacks the language (perhaps not explicitly but certainly as implicitly as can be) required by the statutes, the intent of the testator is not the primary issue. The determinative factor is whether the tax exoneration clause references the QTIP trusts and/or the statutory language by which the QTIP trusts were created.

6. **<u>Reasonable Cause For Failure To File Case Heads To Trial</u>**. <u>The Estate of Vincenzo Sandonato v. United States,</u> _________________ (D. RI. 2025), deals with Mr. Sandonato's estate which failed to file an estate tax return, or to pay the required estate tax, until 10 months after the deadline. The Order notes these background facts:

Vincent Sandonato died on April 12, 2017. At the time of his death, all of Mr. Sandonato's property, such as his business and real estate interests, was held in the name of the Vincent Sandonato Trust (the "Trust"). ECF No. 26 ¶ 6. Under his will and trust agreement, his sister Rita Mayo became executor of his estate and, with her sister Grazia Pia Sandonato, became successor co-trustee of the Trust. *Id.* ¶¶ 3, 7. To assist in handling its estate tax obligations, the Estate retained attorney Joseph Palumbo — who handled Mr. Sandonato's legal affairs for over twenty years. *Id.* ¶ 20; ECF No. 28 ¶ 6. Attorney Palumbo prepared a written memorandum titled "Estate Tax Analysis" that he provided to Ms. Mayo and discussed with her in his office. ECF No. 26 11 33-34. The Estate Tax Analysis represented what was Attorney Palumbo's last written statements related to the Estate's tax obligations. *Id.* ¶ 35.

While Attorney Palumbo was retained, the Estate missed the deadline to file its federal tax return and did not request an extension. *Id.* ¶¶ 43-45. A few months after the tax deadline, the Estate learned that Attorney Palumbo stopped practicing law because of illness and therefore retained new counsel to assist in handling its tax obligations. *Id.* ¶ 49-50. The Estate's new counsel identified mistakes with Attorney Palumbo's tax analysis and — with a certified public accountant firm's help — assisted Ms. Mayo with preparing the Estate's tax return. ECF No. 28 12-14. Ultimately, the Estate filed its tax return ten months after the prescribed deadline. ECF No. 26 ¶ 51.

> Due to the Estate's untimely filing, the IRS assessed a $468,976 failure to file penalty and a $135,482 failure to pay penalty. *Id.* ¶ 52. The Estate filed with the IRS, a request to abate both penalties on the ground that the Estate had "reasonable cause" for filing its tax return late because it relied on its attorney's tax advice. ECF No. 28 ¶¶ 18-19. The IRS denied the abatement request. *Id.* ¶ 19. The Estate appealed the abatement request denial, and, the IRS Appeals Office fully abated the failure to pay penalty and partially abated the failure to file penalty, reasoning that "Measonable cause was not fully met for the failure to file penalty but was full[y] met for the failure to pay penalty." ECF No. 27-9. The Estate then paid the unabated failure to file penalty and associated interest in the amount of $444,068.78. ECF No. 25-16 at 2. Subsequently, the Estate sought a refund of the failure to file penalty, but the IRS denied the request. ECF No. 27-11. Thereafter, the Estate brought forth this suit.

The court noted that a trier of fact could go either way here:

> Based on Attorney Palumbo's Estate Tax Analysis it appears that more information may have been needed to determine whether it was unnecessary for the Estate to file an estate tax return — as Ms. Mayo acknowledged in her deposition.
>
> But Ms. Mayo asserted that she did have a verbal conversation with Attorney Palumbo regarding the Estate Tax Analysis, *see* ECF No. 25-3 at 91, in which he clarified and concluded it was unnecessary for the Estate to file a federal tax return. *See* ECF No. 27-1 ¶¶ 26-27. And Ms. Mayo noted she relied on Attorney Palumbo's conclusion, along with his asset valuations and assessment of which taxable estate assets in the Estate Tax Analysis because she was unfamiliar with federal tax requirements. ECF No. 27-1 ¶¶ 24-31. A reasonable fact-finder could accept Ms. Mayo's assertion that Attorney Palumbo advised her that it was unnecessary to file a tax return and that she relied on such an assertion when neglecting to file such a tax return. The United States argues that Ms. Mayo has not provided any "valid supporting evidence that Attorney Palumbo 'assured' or 'posited"' that it was unnecessary for the Estate to file a federal estate tax return and contends that Ms. Mayo's testimony on that point contradicts her prior sworn testimony. ECF No. 32 at 6. But such an argument raises a credibility issue as to Ms. Mayo, which the Court should not assess when deciding on a summary judgment motion. *See Labreche v. Brouillette*, No. 1:21-CV-00277-JJM-LDA, 2024 WL 3598849, at *5 (D.R.I. July 31, 2024) (quoting *Dominguez-Cruz v. Suttle Caribe, Inc.*, 202 F.3d 424, 432 (1st Cir. 2000) (noting that the "court 'should not engage in credibility assessments' when deciding on summary judgment.")).
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> Based on Ms. Mayo assertions that: (1) she lacked sophistication on tax matters and was unfamiliar with the Estate's assets' valuation; and (2) Attorney Palumbo was familiar with the Estate's assets and competent to manage the Estate's tax matters, a fact-finder could find that it was reasonable for her to rely on Attorney Palumbo's substantive tax advice indicating it was unnecessary to file a return. With the strong indication that Ms. Mayo falls in the category of taxpayers who "are not competent to discern error in the substantive advice of an . . . attorney" a

> reasonable fact-finder can find that it was reasonable for her not "to challenge [Attorney Palumbo], to seek a 'second opinion,' or to try to monitor [him] on the provisions of the [Tax] Code" when faced with Attorney Palumbo's confusing Estate Tax Analysis and ultimate conclusion that the Estate need not file a tax return. *Boyle*, 469 U.S. at 251.

If the case does not settle, a jury will decide credibility.

7. **Reduction in Estate Tax Closing Letter User Fee**. The original fee was $67. The new fee is $56. T.D. 10031.

T. MISCELLANEOUS

1. **GRAT Annuity Payments for SEC Purposes**. In Peter J. Kight, Fed. Sec. L. Rp. P 77403 (C.C.H.), 1997 WL 35393250, the Securities Exchange Commission determined that using stock to make an annuity payment from a grantor retained annuity trust would not be a matchable transaction for purposes of Section 16 of the Securities Exchange Act of 1934 because:

> Grantor, who is subject to Section 16 because he is an officer of a company (the "Company") with common stock registered pursuant to Section 12 of the Exchange Act, proposes to create an irrevocable GRAT for estate planning purposes. Grantor proposes to transfer (the "Transfer") to the GRAT shares of Company common stock (the "Shares") that he currently owns that would constitute less than ten percent of the Company's outstanding common stock.
>
> The GRAT would make a series affixed annuity payments (the "Annuity Payments") to Grantor, payable in either cash or Shares, over a specified time period (the "Annuity Period "). During the Annuity Period, Grantor would be both trustee and beneficiary the GRAT. Following the Annuity period, Grantor's minor child who share his household (the "Children") would be the beneficiaries of the GRAT. The dollar amount of the Annuity Payments would be established at the time of the Transfer. The present value of the Annuity Payments would not exceed the fair market value of the Shares at the time of the Transfer.
>
> It is the Division's view that Rule 16a-13 would apply to both the Transfer and any Annuity Payments paid in Shares. In reaching this conclusion, we note that pursuant to Rule 16a-8(c) the Children's remainder interests in the GRAT would not confer beneficial ownership in the Shares to the Children during the Annuity Period. Accordingly, the Transfer and the Annuity Payments would not change Grantor's pecuniary interest in the Shares. Other transactions in the Shares by the GRAT during the Annuity Period would be considered transactions by the Grantor.
>
> The termination of the Annuity Period would effect a gift of Shares to the Children, which would be eligible for exemption under Rule 16b-5 and reported on Form 5. Following termination of the Annuity Period, pursuant to Rule 16a-1(a)(2)(ii)(A) Grantor would continue to report the Shares held by the Children as beneficially owned by him as long as the Children share Grantor's household.

In Rev. Rul. 2008-22 the IRS concluded that assets may be swapped between the grantor and a grantor trust without transfer tax consequence, if the assets exchanged are of equivalent value. Ought that change the Section 16(b) result? In Nosirrah Management, LLC v. Autozone, Inc., Case No. 2:24-cv-02167 (W. D. TN. 2024), the plaintiffs argue yes:

> GRATs created in the last ten to fifteen years almost always include the power of substitution because of the flexibility described above.
>
> A GRAT that includes this power is different from the GRAT addressed in the *Kight* Letter. Because a GRAT settlor can decide at any time, for any reason, to substitute property into the GRAT in exchange for the shares, a transfer from a GRAT to an insider is no different than a market transfer from an unrelated third party to the insider, and the opportunity for abuse of inside information is plainly present. That is amplified further if the insider himself is the trustee, or has the ability to direct or influence the trustee to deliver the shares in payment of the annuity.
>
> The GRATs at issue here thus almost certainly had the power of substitution. As such, the *Kight* Letter – which has no binding authority in any event – is inapplicable, and the share acquisitions from the GRAT on March 14, 2022 and April 7, 2022 are within Section 16(b).

The Federal District Court disagreed in Nosirrah Management, LLC v. AutoZone, Inc., 2025 WL 1104984 (W.D. TN 2025). The court concluded the plaintiff did have standing as a shareholder of Autozone, and then moved to the crux of the dispute:

> The Parties do not dispute that Rhodes (1) was an officer or director under Section 16(b); (2) sold AutoZone stock; and (3) sold the AutoZone stock within six months of receiving it from the GRATs. (See ECF No. 76 at Page ID 1029–30, 1043.) Additionally, Plaintiff brings its suits on behalf of AutoZone, the security issuer. (See ECF No. 1.) Thus, the last element in deciding Section 16(b) liability is whether Rhodes purchased the stock. See Gwozdzinsky, 156 F.3d at 308.
>
> The Parties main dispute, however, centers around whether the exemption under SEC Rule 16a-13 (the "Rule 16a-13 Exemption") applies to the transaction at issue. (See ECF No. 64-1 at Page ID 526; ECF No. 67-1 at Page ID 687 ("Rhodes'[ ] sole defense to liability is his claim that the acquisitions on March 14 and April 7, 2022[,] are not purchases under Section 16(b), but rather are exempt transactions under [the Rule 16a-13 Exemption]. This is an issue of law for the Court to decide based on undisputed facts.").)
>
> "The SEC ... has provided specific exemptions from Section 16(b)'s general requirements." Jordan v. Flexton, 729 F. App'x 282, 285 (5th Cir. 2018) (cleaned up). The Rule 16a-13 Exemption states "[a] transaction ... that effects only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities shall be exempt from [Section 16(b)]." 17 C.F.R. § 240.16a-13.
>
> Thus, the Court examines two requirements as to whether the Rule 16a-13 Exemption applies here: (1) there was no change in Defendant's pecuniary interest in the AutoZone stock; and (2) there was a change in the form of Defendant's beneficial ownership of the AutoZone stock. See id.

With respect to the pecuniary interest question, the opinion states:

> A "pecuniary interest" is "the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities." 17 C.F.R. § 240.16a-1(a)(2)(i). An "indirect pecuniary interest" in a class of securities includes "[a] person's interest in securities held by a trust, as specified in § 240.16a-8(b)." 17 C.F.R. § 240.16a-1(a)(2)(ii)(E).
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> Here, Rhodes retained an interest in the AutoZone stock in the GRATs because he was the "sole [g]rantor, [t]rustee, and [a]nnuitant" of the GRATs. (ECF No. 75 at Page ID 1014, 1020). He thus had an indirect pecuniary interest in the AutoZone stock when it was held in the GRATs. <u>See</u> 17 C.F.R. § 240.16a-1(a)(2)(ii)(E). Because of this indirect pecuniary interest, the AutoZone stock was attributable to Rhodes. <u>See</u> 17 C.F.R. § 240.16a-8(b)(2).
>
> When Rhodes reacquired the AutoZone stock via the GRAT annuities, he then gained a direct pecuniary interest, as he gained the opportunity to directly profit from the AutoZone stock. <u>See</u> 17 C.F.R. § 240.16a-1(a)(2)(i).
>
> Thus, when Rhodes reacquired the AutoZone stock via the annuities, he maintained a pecuniary interest in the securities, even as it shifted from an indirect to direct pecuniary interest. <u>See</u> 17 C.F.R. § 240.16a-1(a)(2)(i).
>
> ***
>
> Plaintiff seems to dispute the plain text of the regulation, which enumerates an indirect pecuniary interest as an "interest in securities held by a trust." 17 C.F.R. § 240.16a-1(a)(2)(ii)(E). It is undisputed that Rhodes held an interest in the securities in the GRATs, as he was the "sole [g]rantor, [t]rustee, and [a]nnuitant." (<u>See</u> ECF No. 75 at Page ID 1014, 1020). Furthermore, when the AutoZone stock was in the GRATs, Rhodes had the indirect opportunity to profit from the AutoZone stock through his annuity payments. (<u>See</u> ECF No. 76 at Page ID 1032.)
>
> Indeed, the SEC has indicated a pecuniary interest "includes an interest in the income or the corpus of the trust." <u>See</u> Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 34-28,869, 48 SEC Docket 4 n.73 (Feb. 26, 1991) [hereinafter "Act Release No. 34-28,869"]. An interest in the corpus of a trust includes a "right to receive a distribution of the trust's assets." Peter J. Romeo & Alan L. Dye, <u>Section 16 Treatise and Reporting Guide</u> § 6.02[3][c], at 557 (5th ed. 2019). Because Rhodes was the only person with the right to receive a distribution from the GRATs, (ECF No. 75 at Page ID 1015), Rhodes retained a pecuniary interest in the AutoZone stock. <u>See</u> 17 C.F.R. § 240.16a-1(a)(2)(ii)(E); Act Release No. 34-28,869.

The plaintiff challenged the regulation – to no avail:

> Plaintiff puts forth a policy argument, arguing Rhodes' interpretation of the SEC Rules ignores the text and purpose of the statute. (ECF No. 73 at Page ID 979.) This argument is unavailing. Regardless of the nature of the SEC Rules, Congress authorized the Rule 16a-13 Exemption because it gave the SEC power to exempt transactions which it may not have comprehended, <u>see</u> 15 U.S.C. § 78p(b). <u>See</u> Loper Bright Enters. v. Raimondo, 603 U.S. 369, 375 (2024) ("[T]he question that matters [is:] [d]oes the statute authorize the challenged agency

> action?"). Because the transaction at issue falls within the Rule 16a-13 Exemption, it is outside the scope of liability.

Finally, the court also held direction that the remainder beneficiaries of a trust are not beneficial owners for section 16(b) purposes if they have no investment control over the trust assets.

2. **<u>Confidentiality Obligations of Lawyers Posting to Listservs</u>**. ABA Formal Opinion 511 (May 8, 2024), summarizes its conclusion as follows:

> Rule 1.6 prohibits a lawyer from posting questions or comments relating to a representation to a listserv, even in hypothetical or abstract form, without the client's informed consent if there is a reasonable likelihood that the lawyer's questions or comments will disclose information relating to the representation that would allow a reader then or later to infer the identity of the lawyer's client or the situation involved. A lawyer may, however, participate in listserv discussions such as those related to legal news, recent decisions, or changes in the law, without a client's informed consent if the lawyer's contributions will not disclose, or be reasonably likely to lead to the disclosure of, information relating to a client representation.

Quite obviously, lawyers are impliedly authorized to communicate during a representation. Footnote 10 explains that rationale:

> Comment 5 to Rule 1.6 explains that a lawyer is impliedly authorized to make disclosures "when appropriate in carrying out the representation." In many situations, by authorizing the lawyer to carry out the representation, or to carry out some aspect of the representation, the client impliedly authorizes the lawyer to disclose information relating to the representation, to the extent helpful to the client, for the purpose of achieving the client's objectives. *See*, e.g., MODEL RULES OF PROF'L CONDUCT R. 2.3, cmt. [5] ("In many situations, providing an evaluation to a third party poses no significant risk to the client; thus, the lawyer may be impliedly authorized to disclose information to carry out the representation."). For example, when a client authorizes a lawyer to conduct settlement negotiations or transactional negotiations, the client impliedly authorizes the lawyer to disclose information relating to the representation insofar as the lawyer reasonably believes that doing so will advance the client's interests. What is impliedly authorized will depend "upon the particular circumstances of the representation." ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT, *supra* note 6, at 135. *See*, e.g., ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 483 (2018) (lawyer experiencing data breach may reveal information relating to representation to law enforcement if lawyer reasonably believes disclosure is impliedly authorized, will advance client's interests, and will not adversely affect client's material interests); N.C. Formal Op. 2015-5 (2015) ("[p]roviding a client's new appellate counsel with information about the client's case, and turning over the client's appellate file to the successor appellate counsel, is generally considered appropriate to protect the client's interests in the appellate representation" and impliedly authorized); ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 01-421 (2001) (lawyer hired by insurance company to defend insured normally has implied authorization to share with insurer information that will advance insured's interests); *see also* RESTATEMENT OF THE LAW GOVERNING LAWYERS, § 61 (3d ed. 2001) (A lawyer is impliedly authorized to disclose information that "will advance the interests of the client in the representation."). In at least one situation, the Rules

> themselves impliedly authorize the disclosure, even without the client's implicit approval. *See* MODEL RULES OF PROF'L CONDUCT R. 1.14, cmt. [8] ("When taking protective action" on behalf of a client with diminished capacity pursuant to MODEL RULES OF PROF'L CONDUCT R. 1.14(b), "the lawyer is impliedly authorized to make the necessary disclosures, even when the client directs the lawyer to the contrary.").

Accordingly, Opinion 511 notes that client consent to a Listserv posting may be given:

> Not all inquiries to a listserv designed to elicit information helpful to a representation will disclose information relating to the representation. In some situations, because of the nature of the lawyer's practice, the relevant client or the situation involved will never become known, and therefore the lawyer's anonymized inquiry cannot be identified with a specific client or matter. In other cases, the question may be so abstract and broadly applicable that it cannot be associated with a particular client even if others know the inquiring lawyer's clientele. In circumstances such as these, a lawyer may post general questions or hypotheticals because there is no reasonable possibility that any listserv member, or anyone else with whom the post may be shared, could identify the specific client or matter.

Footnote 13 provides this illustration:

> For example, a general question requesting case law on whether a warrantless search of a garbage bin outside a residence violates the Fourth Amendment is less likely to allow a reader to infer the client's identity than a hypothetical revealing the precise facts of a specific search. But if there is a reasonable likelihood that readers can correctly infer the client's identity, then even the general question discloses information relating to the representation, requiring informed consent. For example, a reader could infer that a lawyer who posts a question to a listserv about the constitutionality of searches of garbage bins located outside of a residence is representing a client whose garbage bin was searched, evidence was found, the lawyer would like to move to suppress the evidence, and the lawyer is unsure of all the relevant case law. Regardless of whether the implicit disclosure of this "information relating the representation" is prejudicial to the client, Rule 1.6 provides that if the client's identity could be ascertained, it is the client's decision whether to disclose this sort of information broadly via a listserv to assist the lawyer in conducting useful legal research.

PART 5 – STATE DEVELOPMENTS

U. STATE DEVELOPMENTS

1. Entity Transparency. Courts have gone both ways concerning whether the CTA was constitutional. Some of that litigation continues because the taxpayers worry the CTA will return in the future. In National Small Business United v. Janet Yellen, 2024 WL 899372, the Federal District Court for the Northern District of Alabama, held that the Corporate Transparency Act is unconstitutional. The case is on appeal to the 11th Circuit. The District Court described the issue simply:

> Does the Constitution give Congress the power to regulate those millions of entities and their stakeholders the moment they obtain a formal corporate status from a State? The Government thinks so. While it acknowledges that Congress

"can exercise only the powers granted to it," the Government says that the CTA is within Congress' broad powers to regulate commerce, oversee foreign affairs and national security, and impose taxes and related regulations.

The Government's arguments are not supported by precedent. Because the CTA exceeds the Constitution's limits on the legislative branch and lacks a sufficient nexus to any enumerated power to be a necessary or proper means of achieving Congress' policy goals, the Plaintiffs are entitled to judgment as a matter of law.

***

The Government offers three sources of constitutional authority for Congress' enactment of the CTA. First, the Government argues that Congress has the power to enact the CTA under its foreign affairs powers. That is so, the Government says, because the political branches have plenary power to conduct foreign affairs, and Congress' motivating interest in curbing foreign money laundering and other malign foreign influences places the CTA under the aegis of those powers. Second, the Government argues that Congress has the power to enact the CTA via its Commerce Clause authority. Because many State entities engage in activities that qualify as or affect "commerce," the argument goes, the act of corporate formation itself is enough to invoke Congress' Commerce powers. Finally, the Government asserts that the CTA is a necessary and proper exercise of Congress' taxing power, since one purpose of the FinCEN database created by the CTA is to assist in efficient tax administration.

The court held that internal affairs don't fall within Congressional foreign policy powers:

To be sure, the CTA is not a direct regulation of corporate formation. There are no preemption or commandeering concerns here, *contra* (Doc. 23-1 at 21 n.9), because the CTA does not establish general federal incorporation or force States to demand beneficial owner and applicant information as a filing requirement for incorporation; rather, the CTA is a federal reporting requirement imposed on entities that voluntarily incorporate. Thus, the operative question in light of "[t]he underlying assumptions of our dual form of government," *Kelly v. Robinson*, 479 U.S. 36, 49 n.11, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) (citation omitted), is whether Congress' Foreign Affairs powers justify the CTA's regulation of "creatures of state law," which are ordinarily within the sovereign purview of the States. *Cort*, 422 U.S. at 84, 95 S.Ct. 2080. In this case, the answer is no.

The Supreme Court's unanimous decision in *Bond v. United States* is instructive. 572 U.S. 844, 134 S.Ct. 2077, 189 L.Ed.2d 1 (2014). In *Bond*, a woman inflicted "irritating" but ultimately harmless chemical burns on her husband's mistress. *Id.* at 861, 134 S.Ct. 2077. For that, Bond was prosecuted and convicted for violating the Chemical Weapons Convention Implementation Act of 1998, which "ma[d]e it a federal crime for a person to use or possess any chemical weapon, and ... punishe[d] violators with severe penalties." *Id.* at 848, 134 S.Ct. 2077. The Chemical Weapons Act implemented the international Convention on Chemical Weapons "pursuant to the Federal Government's constitutionally enumerated power to make treaties." *Id.*

On appeal, the Supreme Court overturned Bond's conviction, ruling that the Chemical Weapons Act did not "reach purely local crimes." *Id.* at 860, 134 S.Ct. 2077. Instead, the Court held that because "our constitutional structure leaves local criminal activity primarily to the States," courts "have generally declined to read federal law as intruding on that responsibility, unless Congress has clearly

> indicated that the law should have such reach." *Id.* at 848, 134 S.Ct. 2077. Thus, absent a clear indication from Congress, the Court concluded that Congress' treaty powers did not extend to Bond's "unremarkable" and "purely local" offense. *Id.*

We are accustomed to seeing regulatory efforts like the CTA validated under the Commerce Clause. Here, the court said that could have worked, but Congress blew it:

> These cases also illustrate how easily Congress could have written the CTA to pass constitutional muster. For instance, nothing in *Shultz* or *American Power & Light Co.* would bar Congress from imposing the CTA's disclosure requirements on State entities as soon as they engaged in commerce, or from prohibiting the use of interstate commerce to launder money, "evade taxes, hide ... illicit wealth, and defraud employees and customers." Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. at 59,501. Indeed, Congress has already done so in countless other statutes. *See, e.g.*, 18 U.S.C. § 1343 (criminalizing the communication of information "in interstate or foreign commerce" for the purpose of wire fraud).
>
> But that is not what the CTA does. Because the CTA doesn't regulate the channels and instrumentalities of commerce or prevent their use for a specific purpose, it cannot be justified as a valid regulation of those channels and instrumentalities.
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> ***
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> That brings us to the central question: Does Congress have authority under the Commerce Clause to regulate non-commercial, intrastate activity when "certain entities, which have availed themselves of States' incorporation laws, use the channels of commerce, and their anonymous operations substantially affect interstate and foreign commerce?" (Doc. 40 at 11). The Supreme Court's Commerce Clause decisions all point to the same conclusion: No.
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> Finally, as our analysis began with the text, so too does it end with it. *Octane Fitness*, 572 U.S. at 553, 134 S.Ct. 1749. And the text of the CTA is missing a crucial component of valid substantial effects legislation: it "has no express jurisdictional element which might limit its reach to a discrete set of [activities] that additionally have an explicit connection with or effect on interstate commerce." *Lopez*, 514 U.S. at 562, 115 S.Ct. 1624; *see also* 31 U.S.C. § 5336. The inclusion of a jurisdictional hook is standard operating procedure for Commerce Clause legislation for good reason—it "precludes any serious challenge to the constitutionality of [a] statute as beyond the Commerce power, because it guarantees 'a legitimate nexus with interstate commerce.' " *Goodwin*, 141 F.3d at 400 (quoting *Lopez*, 514 U.S. at 561, 115 S.Ct. 1624).
>
> The absence of a jurisdictional hook from the CTA is even more mystifying because Congress knows how to include one when it wants to. So commonplace are these jurisdictional phrases that, for purposes of statutory interpretation, courts assume that "Congress uses different modifiers to the word 'commerce' in the design and enactment of its statutes." *Cir. City Stores, Inc. v. Adams*, 532 U.S. 105, 115, 121 S.Ct. 1302, 149 L.Ed.2d 234 (2001). When Congress legislates pursuant to its Commerce Clause authority, "[t]he phrase 'affecting commerce' indicates Congress' intent to regulate to the outer limits of its authority under the Commerce Clause," while "the general words 'in commerce' and the specific phrase 'engaged in commerce' are understood to have a more limited reach." *Id.*

The court also rejected the CTA as being valid under the taxing powers because the reporting required, and taxation, are weakly linked. Twenty-two states have joined an amicus brief before the 11th Circuit urging the court to affirm. An example of a contrary opinion is Boyle v. Bessent, 2025 WL 509519 (D. Ct. Me. 2025) where the court held that a corporation is economic activity for commerce clause purposes.

Many accountants have declined to assist with FinCEN filings, for various reasons including liability risk, potential lack of liability insurance coverage, and concerns about engaging in the unauthorized practice of law. On May 8, 2024 the Maryland Attorney General advised the State Board of Public Accountancy that FinCEN compliance would not be the unauthorized practice of law. The opinion concludes:

> In our opinion, the Maryland courts would most likely hold that a CPA may, without violating the prohibition on unauthorized practice of law, provide clients general information about the Transparency Act and the BOIR requirement without tailoring the information to any client's individual situation, or fill out and file a BOIR form using a list of beneficial owners submitted by the client. Though the question is closer, a CPA likely also may help a client to determine whether it is a "reporting company," or to identify its "beneficial owners" within the meaning of the Transparency Act, by walking the client through FinCEN's instructions, by defining terms that are familiar to nonlawyers and/or CPAs, or by answering questions for the client where the question and answer do not call for legal knowledge or skills. However, a CPA generally should not answer a BOIR-related question for a client where there is uncertainty as to the answer and resolving that uncertainty would require legal knowledge, skill, and judgment.

2. Attorney Has No Duty To Non-Client Prospective Beneficiaries. In Fallon v. Easley, 686S.W.3d 287 (Mo. App. 2024), the court considered whether an attorney had any duty to prospective – potential! – beneficiaries of a third amendment to a trust that was not drafted. The court noted these facts:

> A.F. ("Decedent") and her husband had four living children: L.B., M.F., and Appellants Brian and Lara Fallon. Decedent listed these four children as beneficiaries in her Revocable Living Trust initially executed on June 20, 2000. On August 15, 2002, Decedent executed a First Amendment to the trust.
>
> In June 2016, Decedent's husband passed away. Decedent and her four children, L.B., M.F., and Appellants, survived Decedent's husband. Following her husband's death, Decedent retained Respondent to prepare a Second Amendment to the Revocable Living Trust. Under the Second Amendment, M.F. would receive a $10,000 distribution. The three other children, L.B. and Appellants, each would receive "an equal share of the remaining assets with each child's equal share distributed to that child's living descendants should said child predecease Decedent."
>
> After the execution of the Second Amendment, L.B. passed away leaving L.B.'s twin daughters as recipients of L.B.'s share of the trust distribution. In response to L.B.'s death, Decedent, as alleged by Appellants, wanted to remove L.B. and her descendants from the trust to avoid distributing money to some grandchildren but not others. Under the proposed change, Appellants would evenly split L.B.'s one-third share. Respondent never met or spoke directly with Decedent to ascertain her intentions and her mental capacity to make decisions related to amending the Revocable Living Trust.

> On February 25, 2019, Decedent passed away without having executed any amendment to the Second Amended Revocable Living Trust. Thus, an amendment naming Appellants as beneficiaries of the one-third interest of their deceased sibling, L.B., was never executed.
>
> [emphasis added]

The court held for the attorney:

> The undisputed material facts establish that Decedent failed to execute a third amendment to her trust prior to her death. Accordingly, Appellants are at best non-client prospective beneficiaries of the undrafted, unexecuted third amendment to the trust. *See Alberts*, 641 S.W.3d at 379. Attorneys do not owe a duty of care to non-client prospective beneficiaries of unexecuted testamentary documents and the *Donahue* privity exception does not apply, and for good reason. *See id.*
>
> As the *Alberts* Court explained, expanding the *Donahue* exception to impose a duty on an estate planning attorney to non-client prospective beneficiaries, like Appellants here, to timely prepare and gain execution of testamentary documents would compromise the attorney's undivided duty of loyalty to the client to determine her intent, including to execute a plan that may be contrary to what the non-client prospective beneficiaries desire. *Id.* at 375–76 ("Where the relevant testamentary documents are never executed (like this case), issues related to the testator's intent are far more tenuous than where ... the testator's intent has been manifested in an executed document.")
>
> This concern applies with additional force in the circumstances of this case. In *Alberts*, the decedent engaged the defendant lawyers to make changes to his existing estate planning documents and instructed the lawyers to draft amendments to his existing trust agreement to provide for specific distributions to the plaintiffs. The lawyers agreed to do so, but failed to amend and gain execution of the documents before the decedent's death. *Id.* at 371–72. Here, the uncontroverted facts are that, not only did Decedent not execute a third amendment prior to her death, Respondent never met or spoke with Decedent to ascertain her intentions and mental capacity to amend her trust a third time. Thus, no one can know with any confidence whether, as Appellants allege, Decedent wanted to amend her revocable trust to remove her predeceased child, L.B., so that Appellants would receive L.B.'s one-third share, or whether her intent diverged from that of Appellants.

3. **<u>Rights of Unmarried Cohabitants</u>**. The Uniform Law Commission has adopted the <u>Economic Rights of Unmarried Cohabitants Act</u> that, in broad form, absent contrary arrangements by the cohabitants, allows them to bring common law claims based on "contributions to the relationship." Even where such claims are allowed, in the absence of the Act, they can be hard to prove. A concern among some has been that floodgates of litigation would open if cohabitants could sue one another. That concern seems unfounded.

In <u>Pruitt v. Barclay</u>, 663 S.W.3d 799 (Ar. 2023), the court concluded:

> Here the circuit court found that Pruitt's nearly $97,000 renovation of Barclay's home was a gift for which Pruitt did not expect repayment. The circuit court was presented with conflicting testimony from the parties and their witnesses, and it was in the best position to judge the credibility of the witnesses. Ultimately, the

> circuit court credited testimony that Pruitt performed the renovations on the home because he cared about Barclay and wanted her to have somewhere comfortable to live if anything were to ever happen to him. Under these facts, we cannot say that the circuit court erred. Accordingly, we affirm.

The case was a classic case of renovations "improving" a house, but not being renovations the owner could afford:

> Pruitt testified that he spent the money on the renovations because he loved Barclay very much, and they were in an intimate relationship. He said that neither of them wanted to see the home deteriorate any further than it already had. He also stated that it was his understanding that they would use the home as a couple. However, he also testified that he spent so much money because he expected to be repaid. He testified that when he was talking about obtaining a $50,000 loan, Barclay "was agreeable to the loan and said that we could pay it back." He said that he did not get the loan because he had the money. Pruitt testified, "And so, I loaned the money to ourselves and with her saying that we could pay it back. I expected that applied to me loaning the money to us instead of the bank. Save us interest. I did not intend this to be given to her."
>
> Barclay testified that she was deeded the home in 2007. She did not deny the amount of money Pruitt claimed to have spent renovating the home after "significant demolition." She stated that she considered the renovation to be a gift. She admitted that she could not afford to renovate the home; however, she said that she did not ask Pruitt to renovate it either. She stated that she thought Pruitt renovated the home out of "care and love" for her and to "ensure [her] future in case something happened that [she] would have to live there permanently." Barclay testified that she was at the home each time Pruitt was there and that she watched his efforts.
>
> ***
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> Barclay stated that she did not ask Pruitt for the renovations, and she could not afford it with her $15,000 a year income. She said that she did not even know that the roof was getting replaced until she arrived at the home and saw workers on the roof. She stated that there was nothing wrong with the roof when Pruitt replaced it. She said that the 1400-square-foot home was fully functional before she met Pruitt and that now only 1000 square feet are usable because the rooms had been stripped down to the studs and not finished. She testified that there is not a single room completely finished. She stated that her family was able to celebrate Christmas 2015 at the home before the renovations started.
>
> ***
>
> Barclay testified that her weekly income while she and Pruitt were dating was about $270 and that Pruitt was aware of the income because he prepared her income taxes for two years. She stated that she intended to have the home in Dover in case she was unable to work in the future. She said that everything worked in the home. She admitted that she and Pruitt talked about remodeling the house, but she thought they would paint the walls and cabinets and maybe put in new flooring. She said that when she told Pruitt that she could not afford the renovations, he told her "not to worry because he had $50,000 to spend." She stated that they only discussed repayment for the vinyl flooring and backsplash installation. She admitted that if she had never met Pruitt, the home would not be

> "updated or modern," but she said at least all the bathrooms and the kitchen were functional, and everything worked.

The Estate of Thacker v. Timm, 984 N.W.2d 679 (S.D. 2023), involved a long-term relationship:

> Owen Thacker and Victoria Timm met while employed together in the late 1980s. They began a romantic relationship and moved in together at Thacker's residence a short time later. That relationship continued until Thacker died in 2020, but they never married. Each had children from prior marriages. In 2002, Thacker retired and transferred ownership of his solely-owned residence to himself and Timm as joint tenants. Timm retired in 2006. From the beginning of the relationship, the couple shared household expenses informally. In their retirement, the couple purchased three Certificates of Deposit (CDs) using Thacker's funds.

Eventually Thacker suffered poor health and his daughters became co-guardians and co-conservators in 2019. They promptly sued Timm. The trial court found in favor of Timm on all counts. Of note, other than as attorney-in-fact, the court did not hold that Timm had a fiduciary duty towards Thacker:

> The Estate argued that a fiduciary relationship existed between Timm and Thacker because he was not handling his financial affairs and depended on Timm. The Estate heavily relies upon its contention that Thacker has been cognitively impaired since 2014. After finding the facts, the circuit court concluded that Timm owed no other fiduciary duty to Thacker besides the one established by the power of attorney. Because the Estate conceded that Timm had not violated her fiduciary duty arising out of the power of attorney and there was no other fiduciary duty owed, the circuit court found no breach of fiduciary duty.
>
> A mental infirmity could create a circumstance in which a person in a position of confidence could gain an advantage over the person with the infirmity. The circuit court heard the evidence presented and found that Thacker could manage his affairs through September 2018, when he entered the nursing home. Additionally, the circuit court noted the close relationship between Timm and Thacker and specifically found "[t]hey were not unequal in position of influence." These findings are consistent with significant evidence in the settled record.

In Deschane v. Klug, 2 N.W. 3d 131 (MI App. 2022), the court found no fraud and no formal contract between the parties. The court refused to apply quantum meruit or unjust enrichment theories. The opinion states:

> The parties seem to agree on the factual background of this dispute. Plaintiff and defendant began dating in 2008. Plaintiff moved in with defendant and her two daughters. The four of them lived in the house at 260 County Road KCH that defendant owned. Defendant bought that house in 2002, and only her name was on the deed. The parties had two children together, opened joint bank accounts, and combined their resources. During the relationship and cohabitation, defendant handled the majority of the finances, which included managing bank accounts and paying the bills. Defendant worked until 2011, when she started receiving unemployment and disability payments after she was diagnosed with cancer. Plaintiff maintained full-time employment throughout the relationship. In April 2020, defendant inherited approximately $80,000 and bought a second home at 8765 County Road 550, making the down payment of $80,000 from a joint bank account that is at issue on appeal. During their relationship, both parties deposited money into that joint account, which they used to pay bills and the mortgages for

> both houses. In July 2020, defendant ended the relationship and asked plaintiff to leave the homes.
>
> ***
>
> Plaintiff's quantum-meruit and unjust-enrichment claims are more promising than his fraud claims. After all, plaintiff contributed funding and sweat equity to the value of the homes, but he received no compensation from defendant for those contributions. Under Michigan law, "claims for unjust enrichment and quantum meruit have historically been treated in a similar manner." *NL Ventures VI Farmington, LLC v Livonia*, 314 Mich App 222, 241, 886 N.W.2d 772 (2015). "The theory underlying quantum meruit recovery is that the law will imply a contract in order to prevent unjust enrichment when one party inequitably receives and retains a benefit from another." *Morris Pumps v Centerline Piping, Inc*, 273 Mich App 187, 194, 729 N.W.2d 898 (2006). "[T]o sustain the claim of unjust enrichment, plaintiff must establish (1) the receipt of a benefit by defendant from plaintiff, and (2) an inequity resulting to plaintiff because of the retention of the benefit by defendant." *Belle Isle Grill Corp v Detroit*, 256 Mich App 463, 478, 666 N.W.2d 271 (2003).
>
> But theories of quantum meruit and unjust enrichment rarely have a role to play in disputes between unmarried couples. Under Michigan law, "[t]hose engaged in meretricious relationships do not enjoy property rights afforded a legally married couple." *Featherston v Steinhoff*, 226 Mich App 584, 588, 575 N.W.2d 6 (1997). Here, the parties were involved in a meretricious relationship that did not result in marriage, so we will only "enforce an agreement made during the relationship upon proof of additional independent consideration." *Id.* Moreover, "[t]his Court will not allow recovery based on contracts *implied in law or quantum meruit* because to do so would essentially resurrect common-law marriage." *Id.* (emphasis added). Indeed, the "services rendered during a meretricious relationship are presumably gratuitous[,]" *id.* at 589, 575 N.W.2d 6, so plaintiff must bear the burden of rebutting that presumption. *Id.* To do so, "plaintiff must show that [he] expected compensation from defendant at the time [he] rendered services for defendant and that defendant expected to pay for them." *Id.* at 591, 575 N.W.2d 6. The record unmistakably reveals that plaintiff cannot meet that burden.

The plaintiff's fraud claims were treated as only broken promises, because there was no reliance:

> Here, any alleged representations constituted future promises to make plaintiff a co-owner of the houses. To be sure, plaintiff may well have believed that defendant would add his name to the titles to both homes. He alleged in his complaint that defendant had told him that "she *would put* [him] on the title to the [first] home" and that he "*would be* joint owner of the [second] house." His deposition testimony reinforced this point. But even assuming defendant made representations to plaintiff about the homes, those representations constituted, at most, broken promises, and "[a] mere broken promise does not constitute fraud, nor is it evidence of fraud." *Marrero*, 200 Mich App at 444, 505 N.W.2d 275. Accordingly, plaintiff's fraudulent-misrepresentation claim fails for that reason.
>
> Beyond that, plaintiff has failed to show any reliance upon the representations. The record contains no evidence that plaintiff put money or time into the homes in exchange for co-ownership. When plaintiff was asked if there had been "any expectation that ... the two of you would divide things up in any specific fashion," he replied, "No." Plaintiff did not keep track of his hours spent improving the

> homes. The absence of record-keeping combined with the parties' actions during the relationship revealed that plaintiff's acts were the result of the parties' relationship, rather than any form of reliance upon defendant's representations about co-ownership of the homes. In other words, plaintiff's acts were gratuitous in that he acted as he did simply because of his relationship with defendant. Thus, we agree with the trial court that the record contains no evidence of reliance sufficient to support a claim for fraudulent misrepresentation.

A more traditional dispute was at the heart of Aetna Life Insurance Company v. Frank, 592 F.Supp. 3d 317 (S.D. Ny. 2022), namely the effect of beneficiary designations, here between the decedent's mother and girlfriend. The court recites the facts:

> Erich Frank was employed as the Head of Global Services at Union Bank of Switzerland ("UBS"). (*See* Dkt. No. 74 ¶ 1.)2 UBS provided Erich Frank with a life insurance policy, with a face value of $150,000.00, and a 401k plan, with a value of $137,717.68 as of May 7, 2020. (*See* Dkt. No. 74 ¶ 2.) Erich Frank also maintained an RMA with UBS, a personal investment account that, as of November 18, 2020, had a value of approximately $361,071.00. (*See* Dkt. No. 74 ¶ 56.) Frank is Erich Frank's mother. Emily Rosen started dating Erich Frank in 2013 and they moved in together about a year later. (*See* Dkt. No. 74 ¶ 6.)
>
> In August 2017, Erich Frank was diagnosed with Stage 4 colon cancer. (*See* Dkt. No. 74 ¶ 9.) A little over a year later, in December 2018, Erich Frank was admitted into hospice care. (*See* Dkt. No. 74 ¶ 12.) Christopher Ferrara, a friend and co-worker of Erich Frank, arranged for Erich Frank to hire a lawyer, Barbara Lawrence. (*See* Dkt. No. 74 ¶¶ 14, 17.) Lawrence visited Erich Frank at his apartment on December 20, 2018, and Erich Frank signed a number of documents, including a Power of Attorney appointing Lawrence. (*See* Dkt. No. 74 ¶ 19.) On the same day, Ferrara visited Erich Frank's apartment and participated on a recorded phone call with the following individuals: Erich Frank; the Head of Benefits at UBS; and a representative from Alight Solutions, an online platform where UBS employees could make decisions about their benefits. (*See* Dkt. No. 74 ¶¶ 20, 62.) During this call, Erich Frank indicated that he wanted to change the beneficiary designations on his life insurance and 401k from Frank to Rosen. (*See* Dkt. No. 74 ¶ 63.)
>
> Erich Frank's life insurance policy, however, stated that participants could change their beneficiary "by completing a new beneficiary designation form." (*See* Dkt. No. 74 ¶ 40.) His 401k plan similarly stated that participants could change their beneficiaries "by filing a new beneficiary designation form." (*See* Dkt. No. 74 ¶ 43.) After Erich Frank's phone call with the Head of Benefits at UBS and others, UBS mailed him a form dated the same day as the phone call that stated: "For your beneficiary designation(s) to be valid, this form must be completed and returned to Benefits Express by January 20, 2019." (*See* Dkt. No. 74 ¶ 34.) UBS never received this completed form from Erich Frank or Lawrence. (*See* Dkt. No. 74 ¶ 36.) The Head of Benefits at UBS also emailed Ferrara a certification, which attested that Erich Frank was unmarried, for Lawrence to sign. (*See* Dkt. No. 74 ¶¶ 25, 30.) The Head of Benefits at UBS said during the phone call that he needed this certification. (*See* Dkt. No. 55-7 at 10.) Ferrara forwarded the email to Lawrence (*see* Dkt. No. 74 ¶ 31), but there is no evidence that Erich Frank or Lawrence ever responded to this email or signed the certification.
>
> UBS records also indicate that Erich Frank spoke to Frank Sabia, Erich Frank's financial advisor and a UBS employee, about his RMA on December 20, 2018.

> (*See* Dkt. No. 59-15; Dkt. No. 74 ¶ 70.) Following this conversation, Sabia's assistant sent a death beneficiary designation form for the RMA to Rosen. (*See* Dkt. No. 74 ¶ 71.) Rosen faxed the form back with what purports to be Erich Frank's signature. (*See* Dkt. No. 74 ¶ 72.) The form lists Rosen as the beneficiary of Erich Frank's RMA proceeds. (*See* Dkt. No. 59-14.)

When Erich Frank died in 2019, litigation ensued. Interestingly, that Phyllis Frank had never been a beneficiary on the UBS account robbed her of standing:

> Unlike the life insurance and 401k accounts, where Erich Frank previously designated Frank as the beneficiary before switching it to Rosen, the RMA did not have a previously designated beneficiary before Erich Frank purportedly signed a form designating Rosen. Frank prevailing on a claim for the RMA would thus lead to its proceeds going to Erich Frank's estate — instead of Frank — because Frank was never a designated beneficiary of the RMA. Though Frank may have an interest in Erich Frank's estate as a beneficiary in his will or through intestacy, "in New York, heirs suing for damages resulting from a diminished inheritance generally have no standing to sue because 'legatees and beneficiaries thereof have no independent cause of action either in their own right or in the right of the estate to recover estate property.' " *Witzenburg v. Jurgens*, No. 05 Civ. 4827, 2007 WL 9710763, at *9 (E.D.N.Y. Mar. 1, 2007) (quoting *Wierdsma v. Markwood Corp.*, 53 A.D.2d 581, 384 N.Y.S.2d 836, 837 (1st Dep't 1976)). In response, Frank does not contest that any claims she would bring for the RMA would be brought on behalf of the estate. Frank instead argues that this is a "circumstance[ ] where it is necessary to grant a third party standing to assert the rights of another." (Dkt. No. 68 at 17) (quoting *Kowalski v. Tesmer*, 543 U.S. 125, 130, 125 S.Ct. 564, 160 L.Ed.2d 519 (2004)).

In Matter of Estate of Polisseni, ___ N.Y.S.3d ___ (NY Sur. 2022), Juliet Catalfo claimed she was owed for services provided to Greg Polisseni, who died suddenly from a head injury. The opinion states:

> Juliet's claims are, at various times in the submissions, characterized as a breach of an implied and/or express contract; or as falling within the doctrine of promissory estoppel. They relate to Juliet's rendering of services as a "care giver, "life saver," chauffeur, "as an employee of Artistix," an enterprise owned by Greg, and as manager for the construction of a home he was building.
>
> Viewing all claims and the submissions in support in the light most favorable to Juliet, she has not set forth facts sufficient to raise a question of fact requiring a trial.
>
> The text messages between Greg and Juliet,1 and the plain reading of Juliet's affidavit, do not establish the existence of a contract, express or implied. As the Court of Appeals held in *Dombrowski v. Somers*, 41 N.Y.2d 858, 859, 393 N.Y.S.2d 706, 362 N.E.2d 257 [1977], a case that is almost exactly on point and in which the claimant alleged that she provided the decedent "nursing care, cooking, cleaning, marketing and similar tasks" for which the claimant was compensated in her lifetime:
>
> > "The words to 'take care of', in the context of this record, are too vague to spell out a meaningful promise" and are "legally insufficient to support a finding that there was a contract to compensate plaintiff during her lifetime. "

Dombrowski v. Somers, 41 N.Y.2d 858, 859, 393 N.Y.S.2d 706, 362 N.E.2d 257 [1977].

Like the claimant in *Dombrowksi*, Juliet concedes that she was paid for the services she rendered Greg.

***

Juliet does not shy from making it clear that she and Greg were romantically involved. That does not help her argument, but rather, puts it exactly within the fact pattern in *Morone v. Morone*, 50 N.Y.2d 481, 488-489, 429 N.Y.S.2d 592, 413 N.E.2d 1154 [1980], in which the learned Hon. Bernard Meyers, writing for a unanimous Court of Appeals, eloquently stated that:

> A court cannot recognize an implied contract for domestic services between domestic partners—especially cohabitating domestic partners—in large part because of the "substantially greater risk of emotion-laden afterthought, not to mention fraud, in attempting to ascertain by implication what services, if any, were rendered gratuitously and what compensation, if any, the parties intended to be paid" (*Morone*, 50 N.Y.2d at 488, 429 N.Y.S.2d 592, 413 N.E.2d 1154).
>
> "The notion of an implied contract between an unmarried couple living together is ... contrary to both New York decisional law and the implication arising from our Legislature's abolition of common-law-marriage" (*Morone*, 50 N.Y.2d at 489, 429 N.Y.S.2d 592, 413 N.E.2d 1154).
>
> "As a matter of human experience personal services will frequently be rendered by two people living together because they value each other's company or because they find it a convenient or rewarding thing to do" (*Morone*, 50 N.Y.2d at 488, 429 N.Y.S.2d 592, 413 N.E.2d 1154).

Thus, to the extent the contract between Juliet and Greg was implied, her claim is barred by the holding in *Morone*.

Juliet relies heavily on the Court of Appeal's more recent decision, (*Matter of Hennel*, 29 N.Y.3d 487, 490, 58 N.Y.S.3d 271, 80 N.E.3d 1017 [2017]). There petitioners sought under a theory of promissory estoppel to enforce an oral promise made by the decedent that would otherwise be void under the statute of frauds and EPTL 13-2.1, subd. (a), par. (2). Decedent had promised his grandsons that his estate would satisfy the balance of a mortgage he had taken out to help them purchase property, a promise he left out of a 2008 will.

The Court, acknowledging that it had not yet "expressly recognized this principle," held that "where the elements of promissory estoppel are satisfied and enforcement of the statute of frauds would inflict such an unjust and egregious result upon the party who detrimentally relied on the oral promise that the resulting injury would be unconscionable, the opposing party may be estopped from relying on the statute of frauds" *Matter of Hennel*, 29 N.Y.3d 487, 489, 493, 58 N.Y.S.3d 271, 80 N.E.3d 1017 [2017].

Nonetheless, the court reversed the lower court and dismissed the claim, finding that while the claimants had relied to their detriment on a promise made by the decedent, they would not suffer "unconscionable injury" if the statute of frauds

> and EPTL 13-2.1, subd. (a), par. (2) were enforced (*Matter of Hennel*, 29 N.Y.3d 487, 496, 58 N.Y.S.3d 271, 80 N.E.3d 1017 [2017]).
>
> Here Juliet claims to have relied to her detriment upon Greg's "promise" to "take care" of her, and to give her ownership of the house he was building. Her detriment was the income she gave up attending to Greg's needs and desires and reflected in the amount of the claim she now makes against the Estate.
>
> *Hennel* is inapplicable to the instant matter for several reasons.
>
> It does not overrule the holding in *Dombrowski*, which held that the words "take care of" are too vague to qualify as a promise. That ambiguity is to be contrasted with the promise in *Hennel,* in which the decedent drew up a will (later abrogated), in which he explicitly set forth a promise to satisfy the mortgage debt owed by his grandsons.
>
> *Hennel* does not overrule *Morone* which refused to recognize promises made (as an assertion of the existence of an implied contract) in the context of an "intimate," partnered, live-in relationship.
>
> Finally, even if Greg's statements were promises of future compensation, Juliet has not shown, as a matter of law and giving her submissions the benefit of every possible inference, that she suffered an "unconscionable injury. "

The bottom-line appears to be that boyfriends and girlfriends in New York are not going to get to trial:

> During the course of her relationship with Greg she was compensated, having been provided with a place to live (with Greg and sometimes his mother), money to cover her expenses, and all the benefits of the intimacy of their relationship. Juliet has provided text messages attesting to the satisfaction Greg found in her company, and the reasonable inference can be made from the submissions (even without taking into consideration the "salacious" texts and images referred to by counsel for Juliet) that the feeling was mutual.
>
> The arrangement between Greg and Juliet does not qualify as "one such as no person in his or her senses and not under delusion would make on the one hand, and as no honest and fair person would accept on the other, the inequality being so strong and manifest as to shock the conscience and confound the judgment of any person of common sense" (*Matter of Hennel*, 29 N.Y.3d 487, 495, 58 N.Y.S.3d 271, 80 N.E.3d 1017 [2017], citing *Christian v. Christian,* 42 N.Y.2d 63, 71, 396 N.Y.S.2d 817, 365 N.E.2d 849 [1977] [internal quotation marks, brackets, and citations omitted]; *see generally Gillman v. Chase Manhattan Bank,* 73 N.Y.2d 1, 10–12, 537 N.Y.S.2d 787, 534 N.E.2d 824 [1988]; *Mandel v. Liebman,* 303 N.Y. 88, 94–96, 100 N.E.2d 149 [1951]).
>
> To find a question of fact under the circumstances presented here would render the holdings in *Morone* and *Dombrowski* overruled, which *Hennel* did not intend to do.
>
> Accordingly, the claimant has failed to establish a question of fact requiring a trial.

Even when relationships end with a settlement agreement, there can be ambiguity and confusion. In Matter of Estate of Arnold, 553 P.3d 264 (Colo. App. 2024), the opinion summarizes the situation:

> This probate case, which involves competing claims to funds from a bank account with First Colorado National Bank formerly owned by the decedent, Michael P. Arnold, presents novel issues concerning the waiver of payable on death (POD) assets through a settlement agreement. Annette M. English, who was previously in a romantic relationship with the decedent and thereafter remained designated as the POD beneficiary of the bank account, contends that she owns the account funds as a matter of law. But Lynn M. Arnold, who is the decedent's sister, the personal representative of his estate, and the primary beneficiary under his will, contends that the account funds belong to the estate because English waived her interest through a settlement agreement she entered into with the decedent after their relationship ended.
>
> We conclude that the settlement agreement didn't waive English's expectancy interest in the POD account. Therefore, we reverse the district court's order holding that the account funds belong to the estate, and we remand the case with instructions to enter an order holding that those funds belong to English.
>
> ***
>
> As an initial matter, English's interest in the POD account is not a claim that is "related to" her "past relationship" or "financial dealings" with the decedent. While the decedent initially may have designated English as the beneficiary because of their relationship and intertwined finances, English's rights in the account funds derive from the POD designation alone — not from her previous relationship or financial dealings with the decedent. And there is no indication that the decedent was ever obligated, by virtue of the parties' relationship or financial dealings, to list or to retain English as a beneficiary. *See PaineWebber Inc. v. East*, 363 Md. 408, 768 A.2d 1029, 1033 (2001) (a former spouse's interest in a POD account wasn't "based on status or relationship as a spouse" but, rather, was "under a contract right, as the named beneficiary"); *Maccabees Mut. Life Ins. Co. v. Morton*, 941 F.2d 1181, 1185 (11th Cir. 1991) (applying Georgia law) (a former spouse's interest as the beneficiary of a POD account was "unrelated to the husband-wife relationship of the parties," as the decedent "was never obligated to designate [her] as a beneficiary" and "was never prevented from removing her as a beneficiary, either before or after their divorce").
>
> More generally, English's interest in the POD account doesn't constitute a "claim" against the decedent or his successors or assigns within the meaning of the settlement agreement. When they entered into the settlement agreement, the decedent owned the bank account outright and English had no rights in it. *See* § 15-15-211(3); *Est. of Westfall*, 942 P.2d at 1230. Rather, as the POD beneficiary, English's interest was merely one of expectancy. *See In re Estate of DeWitt*, 54 P.3d 849, 856 (Colo. 2002) (a beneficiary of a life insurance policy possesses only an expectancy, or contingent, interest in the policy during the insured's lifetime); *see also In re Estate of Allmaras*, 2007 ND 130, ¶ 20, 737 N.W.2d 612, 617 (interpreting statutory language similar to that in section 15-15-211(3) as conferring no rights upon the POD beneficiary during the account owner's lifetime); *Jordan v. Burgbacher*, 180 Ariz. 221, 883 P.2d 458, 464-65 (Ct. App. 1994) (same). Because she held only an expectancy interest in the account, English couldn't assert any claim to it during the decedent's lifetime.

> To be sure, the decedent retained the right to remove English as the POD beneficiary at any time, even after entering into the settlement agreement. He simply "chose not to do so or failed to exercise that right." *Ex parte Pitts*, 435 So. 2d 83, 85 (Ala. 1983). Only when he died, without having changed the POD designation, did English have any rights in the account. And even if we were to interpret the settlement agreement to include future claims, as the district court did, English's interest didn't become a "claim" against the decedent or his estate when he died. Rather, it became an ownership right in the bank account itself. *See Jordan*, 883 P.2d at 465 (an interest as a POD payee is a right arising from a contract of deposit, not a claim or right to share in a decedent's estate); *Kruse v. Todd*, 260 Ga. 63, 389 S.E.2d 488, 491 (1990) (a claim to proceeds from a life insurance policy is against the insurer, not the decedent).
>
> ***
>
> In this case, although the settlement agreement has broad release language, it doesn't mention the POD account or any survivorship interests or expectancies. Therefore, regardless of whether English was aware of the beneficiary designation at the time of the agreement (a fact on which the parties disagree), the agreement isn't specific enough to effectuate a waiver of her expectancy interest in the POD account.
>
> We reject the personal representative's argument that awarding the account funds to English gives her a windfall. We cannot know why the decedent never modified the account to remove English as the POD beneficiary; nor does it make any difference as a legal matter. And whether it creates a windfall or not is not for us to discern. Our role is simply to apply the law as written — and that law mandates that English, as the designated POD beneficiary, receive the account funds in the absence of any waiver of her interest in them.
>
> We also reject the personal representative's reference to a court's broad equitable discretion when acting in probate. *See generally Beren v. Beren*, 2015 CO 29, ¶ 19, 349 P.3d 233. The district court in this case didn't rule based on any equitable bases, such as undue influence (another concept the personal representative has referenced in this appeal). Instead, the court merely applied legal principles to interpret the scope of the settlement agreement — and, as we've indicated, we review that interpretation de novo.

In Tremblay v. Bald, 2024 N.H. 6 (NH S. Ct. 2024), the Supreme Court of New Hampshire concluded that continued cohabitation would be sufficient consideration for an agreement in which a deceased cohabitant had agreed to leave assets to the surviving cohabitant. The court summarized the facts as follows:

> The following facts are undisputed. The plaintiff and the decedent were in a romantic relationship and lived together for more than ten years beginning in November 2009. They became engaged on December 31, 2009, but never married. They remained engaged and continued to live with each other until the decedent died intestate on July 26, 2020.
>
> At the time they met, the plaintiff was living at 19 Spruce Street and the decedent was living at 16 Spruce Street, in Gorham. As the relationship progressed, the plaintiff moved in with the decedent at 16 Spruce Street. In December 2009, the decedent purchased the plaintiff's property at 19 Spruce Street. On January 1, 2012, they executed a notarized agreement superseding a prior agreement from December 2009. The January 2012 agreement provides, in pertinent part:

> In the event that [the decedent] passes away and we are living together, [the plaintiff] will choose to keep, free and clear of any encumbrance, either the 16 Spruce St. property or the 19 Spruce St. property, including the contents of her choice; and the choice of two vehicles. This does not include [the decedent's] gun collection.

They subsequently executed two more notarized agreements, each dated March 30, 2015. One of these agreements provides, in relevant part: "I, [the decedent], in the event of my death, leave to [the plaintiff] the 2014 Ford Mustang ...; as long as we are still living together as an engaged couple." The other agreement provides, in relevant part:

> I, [the decedent], in the event of my death, leave to [the plaintiff] free and clear of any encumbrances, the property at 1 Marois Ave, Gorham, NH (including a garage and park model home); as long as we are still living together in the same household.
>
> This sheet being the third of three that we, as fiancees, have thus far completed. There is no Will at this time.

Obviously, that the agreements were memorialized in writing was helpful. The issue was whether there was consideration. The court held there was:

> The defendants argue that the agreements lacked consideration, in part, because the plaintiff and the decedent were already living together at the time the agreements were executed. Specifically, they argue that the plaintiff was not induced into living, or continuing to live, with the decedent because of the agreements. We disagree.
>
> Consideration is present if there is either a benefit to the promisor or a detriment to the promisee. *Chisholm v. Ultima Nashua Indus. Corp*., 150 N.H. 141, 145, 834 A.2d 221 (2003). "The law does not undertake to measure the adequacy of the consideration for a contract or agreement." *Probate v. Adams,* 49 N.H. 150, 154 (1869). "The slightest benefit conferred upon the one party, or the slightest loss or inconvenience sustained by the other, is sufficient." *Id*.
>
> The agreements meet this test. The plaintiff's continued cohabitation amounted to a benefit to the decedent, as promisor. It served as a benefit to the decedent because, as the agreements plainly reflect, he desired that the plaintiff continue to live with him. Thus, the agreements reflect a bargained-for exchange: that the decedent would leave certain property to the plaintiff if she continued to live with him until his death. <u>See</u> *Panto v. Moore Business Forms, Inc.*, 130 N.H. 730, 740, 547 A.2d 260 (1988) (stating that a bargained-for exchange "means simply that the promisor must manifest an intent to induce a promise or performance and the promisee must manifest a corresponding intention").

4. **<u>Malpractice Action Not Dismissed</u>**. In <u>Wellin v. Farace</u>, 2023 WL 2918919 (D. Ct. S.C. 2023), the Federal district court refused to dismiss a malpractice claim. The case involves interesting evidentiary matters, but of primary interest to estate planners is the central substantive claim by the plaintiff. The decedent formed a limited partnership in 2003 that owned $90 million of Berkshire-Hathaway stock. The decedent owned 98.9% of the partnership and the decedent's children through an LLC owned 1.1%. In 2008, the decedent was diagnosed with cancer, and in 2009 he sold his units to an irrevocable grantor trust for a note (taking a 45% discount). In 2013, the decedent fired his lawyer, hired new counsel, and sued the children saying he didn't know he had lost control over the partnership and he didn't know that if the children sold the stock while he was living then he would pay the income tax. Late in 2013, the stock was sold and the decedent died in September 2014. Whether the decedent would have done the sale had he known what would happen if the stock were sold during his lifetime is the front and center issue. However, another element of potential damages is "lost profit," on account of the sale.

5. **Malpractice Frequency**. The ABA Journal reported on May 22, 2024, that the three practice areas with the most malpractice claims were trusts and estates, business transactions, and corporate and securities law. The report notes that there is more wealth and more older people, but also more transactional relationships with law firms whose clients don't know the lawyers very well.

6. **Modification of a Revocable Trust Under California Law**. Practitioners in states without robust "legislative history" often wish we had it. California has more than most, but Haggerty v. Thornton, 2024WL482536 (Cal. 2024) indicates confusion can still reign. The issue was commonplace: settlor's revocable trust had a provision reserving to the settlor "[t]he right by an acknowledged instrument in writing to revoke or amend this Agreement or any trust hereunder." So what happened? The opinion states:

> In 2016, Bertsch drafted an amendment providing for a distribution to Haggerty. The amendment was signed by Bertsch and notarized.
>
> In 2018, Bertsch drafted an amendment providing that half of her assets would go to various beneficiaries upon her death, including the Union of Concerned Scientists, Patricia Galligan, and Racquel Kolsrud, who are respondents in this case. Haggerty was not listed as one of the beneficiaries. The 2018 amendment was signed by Bertsch but not notarized. Thus, the 2018 amendment was compliant with the statutory method but not with the method of modification specified in the trust instrument.
>
> After Bertsch's death, Haggerty filed a petition to determine the validity of the 2018 amendment. Haggerty argued that the amendment does not qualify as an "acknowledged instrument" because it was not notarized and therefore was not modified pursuant to the method of modification specified in the trust instrument. In a minute order, the probate court held that the 2018 amendment was valid.
>
> The Court of Appeal affirmed, holding that Bertsch's 2018 amendment was a valid modification pursuant to the statutory method. (*Haggerty v. Thornton* (2021) 68 Cal.App.5th 1003, 1012, 284 Cal.Rptr.3d 32 (*Haggerty*); see §§ 15401, subd. (a)(2), 15402.) The court concluded that the statutory method was available for modification because Bertsch's trust agreement "does not distinguish between revocation and modification" and because "the method of revocation and modification described in the trust agreement is not explicitly exclusive." (*Haggerty*, at p. 1012, 284 Cal.Rptr.3d 32.)
>
> We granted review to resolve a split of authority regarding the circumstances under which the statutory method is available for modification when a method of modification is specified in the trust instrument.

The opinion describes the "statutory method" as follows:

> Section 15402 of the Probate Code states that "[u]nless the trust instrument provides otherwise, ... the settlor may modify the trust by the procedure for revocation." (Prob. Code, § 15402; all undesignated statutory references are to this code.) Section 15401 sets out the procedures for revocation: Trusts may be revoked by complying with any method provided in the trust instrument. (§ 15401, subd. (a)(1).) If the trust instrument explicitly makes that method exclusive, then the trust may be revoked only in that manner. (§ 15401, subd. (a)(2).) If not, then the trust may also be revoked by the statutory method — "a writing, other than a will, signed by the settlor or any other person holding the power of revocation and delivered to the trustee during the lifetime of the settlor or the person holding the power of revocation." (*Ibid.*)

Fascinatingly, the appellate courts had conjured up three different rules on this issue. One, unless the trust instrument "provides otherwise" indicates that if any modification method is specified in the trust, that method must be used to amend the trust; two, "provides otherwise" means "unless the trust provides a modification procedure and explicitly makes that method exclusive;" and three, "provides otherwise" also means "unless the trust instrument distinguishes between revocation and modification." Here, the court held that "a trust may be modified via the section 15401 procedures for revocation, including the statutory method, unless the trust instrument provides a method of modification and explicitly makes it exclusive, or otherwise expressly precludes the use of revocation procedures for modification."

7. **<u>Meaning of Child Under Florida Law For Social Security Purposes</u>**. <u>Steele v. Commissioner</u>, 2024WL861259 (11th Cir. 2024) applied Florida law as answered by the Florida Supreme Court to deny "child" status to a posthumously conceived child for Social Security purposes. The opinion first reminds us of the approach of federal law:

> Under the Social Security Act, an applicant qualifies for CIB if he "meets the Act's definition of 'child,' is unmarried, is below specified age limits (18 or 19) or is under a disability which began prior to age 22, and was dependent on the insured at the time of the insured's death." *Astrue v. Capato ex rel. B.N.C.*, 566 U.S. 541, 547, 132 S.Ct. 2021, 182 L.Ed.2d 887 (2012); 42 U.S.C. § 402(d). The Social Security Act defined "child," in relevant part, as "(1) the child or legally adopted child of an individual, (2) a stepchild [under certain circumstances], and (3) ... the grandchild or step-grandchild of an individual or his spouse [who meets certain conditions]." *Astrue*, 566 U.S. at 547, 132 S.Ct. 2021 (alterations in original); 42 U.S.C. § 416(e). Additionally, a subsequential definition provision—42 U.S.C. § 416(h)(2)(A)—provides that "[i]n determining whether an applicant is the child or parent of [an] individual for purposes of this subchapter, the Commissioner of Social Security shall apply [the intestacy law of the insured individual's domiciliary State]." *Astrue*, 566 U.S. at 548, 132 S.Ct. 2021 (some alterations in original) (quoting § 416(h)(2)(A)). Section 416(h)(2)(A) "completes the definition of 'child' 'for purposes of th[e] subchapter' that includes § 416(e)(1)." *Id.* at 558, 132 S.Ct. 2021 (quoting § 416(h)(2)(A)).

So, the question here was whether a posthumous child could inherit under the decedent father's Will. The court noted the terms of Mr. Steele's Will:

> Additionally, before Mr. Steele's death, he prepared a will that specifically listed his living children but also stated, "[t]he terms 'children' and 'lineal descendants' shall include those later born or adopted and whenever used in this instrument shall be equivalent to blood relationship and relationship by adoption." *Id.*

The Florida Supreme Court held that such language would not sweep in a posthumous child:

> "Whether posthumously conceived children can inherit through intestacy under Florida law" was a question of first impression for this Court, *Steele I*, 51 F.th at 1063, and the parties disputed the meaning and application of Florida Statute § 742.17(4) to the case, which provides that a "child conceived from the eggs or sperm of a person or persons who died before the transfer of their eggs, sperm, or pre-embryos to a woman's body shall not be eligible for a claim against the decedent's estate *unless the child has been provided for by the decedent's will*." (Emphasis added). Given this, we certified two questions to the Florida Supreme Court: (1) "[u]nder Florida law, is P.S.S. 'provided for' in the decedent's will within the meaning of Fla. Stat. § 742.17(4)?"; and (2) "[i]f the answer is yes, does Florida law authorize a posthumously conceived child who is provided for in the decedent's will to inherit intestate the decedent's property?" *Steele I*, 51 F.4th at 1065.
>
> After considering our certified questions, the Florida Supreme Court determined that the first question—the interpretation of the phrase "provided for" in section 742.17(4)—was dispositive. *Steele II*, at ——, 2024 WL 630219, at *2. Applying the supremacy-of-text principle to section 742.17(4), the Florida Supreme Court noted that "[t]he term 'provided for' is not defined in the statute or in any other part of chapter 742." *Id.* (quoting § 742.17(4)). Therefore, the court looked to other "sources bearing on its objective meaning." *Id.* After considering "era-appropriate" dictionaries and its case law in a related context, the Florida Supreme Court concluded that " 'provided for' in section 742.17(4) means that the testator actually left something to the posthumously conceived child through the will," i.e., "the child must have some inheritance right under the will." *Id.* at ——, 2024 WL 630219, at *3. As part of this requirement, the court explained, "the will must show that the testator contemplated the possibility of a child being conceived following his or her death." *Id.*
>
> Applying this standard to the facts of this case, the Florida Supreme Court determined that Mr. Steele's will did not "provide for" P.S.S. because "[n]o part of the will acknowledges the possibility of children being conceived after Mr. Steele's death." *Id.* The court interpreted the will's reference to afterborn or adopted children as referring "most naturally to children born after his will was drafted but conceived before his death, i.e., when the dispositional portions of the will create vested rights." *Id.* "Thus, this reference to later-born children would not cover P.S.S., who was conceived after Mr. Steele's death." *Id.*
>
> Moreover, the Florida Supreme Court found that, even if "post-death conception was in some generic sense contemplated by Mr. Steele, P.S.S. could not have received anything under the will," as "Mr. Steele's will conveyed *all* relevant property to Ms. Steele." *Id.* The court explained that, "[i]n the event that Ms. Steele had died before Mr. Steele, the tangible personal property would have been distributed to his 'then living children.' " *Id.* "By its terms," the court explained,

> "this fallback provision only applied to children living at the time Mr. Steele died and necessarily excluded any posthumously conceived children, like P.S.S." *Id.* Thus, the Florida Supreme Court concluded that "as it was impossible for P.S.S. to inherit anything from the will, it is clear that Mr. Steele did not provide for P.S.S. as contemplated by section 742.17(4)." *Id.*

The conclusion is not self-evident. Most wills with a surviving spouse leave nothing to children until the surviving spouse dies. The Florida statute is not clear on when a child must be a beneficiary. Suppose the surviving spouse/mom had realized this would be the result and had disclaimed $100 to that would be divided among children, or perhaps disclaimed the father's watch and other jewelry. If the posthumous child receives something under the Will, the child is a beneficiary who receives something by intestacy, which seems circular.

8. **<u>Principal and Income Act: Entity Distribution Rules</u>**. At issue in <u>Matter of Crider Family Share Trust</u>, 379 So.3d 885 (2024), was whether a distribution from an entity was principal or income. Mississippi had adopted the 1997 version of the Revised Uniform Principal and Income Act which provides:

> Mississippi Code Section 91-17-401, states, in pertinent part:
>
> (b) Except as otherwise provided in this section, a trustee *shall allocate to income* money received from an entity.
>
> (c) A trustee *shall allocate* the following receipts from an entity to *principal*:
>
> ....
>
> ....
>
> (3) Money received in total or partial liquidation of the entity; and
>
> ....
>
> (d) Money is received in partial liquidation:
>
> (1) To the extent that the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation; or
>
> (2) If the total amount of money and property received in a distribution or series of related distributions is *greater than twenty percent (20%) of the entity's gross assets* as shown by the entity's year-end financial statements immediately preceding the initial receipt.
>
> (e) Money is not received in partial liquidation, nor may it be taken into account after subsection (d)(2), to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of the entity that distributes the money.
>
> Miss. Code Ann. § 91-17-401 (Rev. 2021) (emphasis added).

The Company's leadership did not indicate the company was liquidating, so the precise question was how to calculate the 20%:

> First, it is evident that Muskegon has not indicated that the 2020 distributions were in partial liquidation under Section 91-17-401(1); indeed, Muskegon's president, Joel R. Myler, stated that the company has no intention of liquidating its assets, neither partially nor fully. Therefore, the only available avenue of recovery for Ricklin and Woolwine is to prove that Muskegon's 2020 distributions were greater than 20 percent of the entity's gross assets under Section 91-17-401(d)(2).
>
> Ricklin and Woolwine calculated that Muskegon's distributions constituted 21.945 percent of its gross assets. In reaching the figure, Ricklin and Woolwine's determined that Muskegon's total distributions for the year 2021 were $35,650,940, and its 2020 gross assets were $159,793,260. Thus, Ricklin and Woolwine divided the 2021 distribution by the 2020 gross assets to reach 21.945 percent.
>
> Sheffield, on the other hand, argues that Muskegon's distributions only constituted 13.6 percent of its gross assets. She agreed that Muskegon's 2021 distributions were $35,650,940, but, in contrast, she found that Muskegon's 2020 gross assets were $257,669,786. Sheffield asserts that Ricklin and Woolwine's calculation was incorrect because they failed to properly calculate Muskegon's *gross assets* as provided in Section 91-17-401(d)(2) but rather relied on Muskegon's *total assets*. Specifically, she argues that, under the general definition of gross assets (the fair market value unencumbered by any liabilities), Muskegon's 2020 assets had to be adjusted for that year's depreciation and depletion. Muskegon's depreciation for 2020 was $59,971,529, and its depletion for 2020 was $41,064,248, thereby making the 2020 gross assets $257,669,786.
>
> Moreover, even if Ricklin and Woolwine had properly calculated Muskegon's 2020 gross assets, Sheffield points out that their determination would still be flawed because they failed to consider Section 91-17-401(e) in their calculations; indeed, Ricklin and Woolwine's expert admitted that subsection (e) would change the results. Sheffield's expert found that the total distributions, less the tax liability, reduced the percentage of distribution of assets to roughly 15 percent.

The court held that the distributions were tax-affected:

> In response, Ricklin and Woolwine cite *Scurrah v. Elder*, an unpublished California Court of Appeals case that implicitly held the amount of income tax is ignored when determining partial liquidation. *Scurrah v. Elder*, No. B268995, 2017 WL 3866784 (Cal. Ct. App. 2017). Ricklin and Woolwine further bolster their argument by referencing comments to the Principal and Income Act that, in their view, refute the plain meaning of subsection (e) and instead mandate that the partial liquidation calculation is determined on a post-tax basis. The Court notes, however, that Mississippi has neither adopted any comments to its Principal and Income Act nor any holding in *Scurrah*, an unpublished, nonbinding opinion from another jurisdiction; thus, we remain unmoved by Ricklin and Woolwine's argument, which is inapposite to the plain reading of subsection (e).

9. **<u>Tax Apportionment Clause Construction Under Nebraska Law</u>**. Nebraska's default tax apportionment rule is that taxes are apportioned to the recipient of property. Suppose a trust provides that inheritance taxes will be paid from this trust, where the trust provides for a specific distribution of an asset before the distribution of the remaining assets. That was considered in <u>Shaddick . Hessler</u>, 316 Neb. 600 (NE 2024). The trust provided that a house would be distributed outright to the deceased settlor's girlfriend before all other assets went to the decedent's children. The opinion states:

In 2006, the decedent executed the trust. According to the trust's language, the decedent was "desirous of establishing a trust for the benefit of his children, issue and himself."

The focus of this appeal is paragraph 7 of the trust. The first two subparts of that paragraph provided for the payment of taxes, expenses, and debts. The latter two subparts addressed distribution of personal property, income, and principal. The paragraph stated:

> 7. USAGE OF TRUST PROPERTY ON AND AFTER SETTLOR'S DEATH.
>
> **a. PAYMENT OF TAXES.** The Successor Trustee shall pay from this trust all inheritance and estate taxes due by reason of the Settlor's death irrespective of whether such taxes are in respect of the trust property.
>
> **b. PAYMENT OF EXPENSES AND DEBTS.** The Successor Trustee shall pay the funeral and related expenses of the Settlor together with the expenses of last illness not covered by [M]edicare or insurance. Additionally, the Successor Trustee may pay such of the debts and obligations of the Settlor as the Successor Trustee determines appropriate under the circumstances. In further addition, the Successor Trustee may pay the expenses of administering Settlor's estate, it being the express intention of the Settlor that the Successor Trustee take such actions as are appropriate to bring about an efficient and orderly administration of Settlor's estate.
>
> **c. DISTRIBUTION OF TANGIBLE PERSONAL PROPERTY.** The Successor Trustee shall distribute items of tangible personal property pursuant to and in accordance with a list prepared by the Settlor and delivered to the Successor Trustee, or found among Settlor's documents and papers after death, indicating certain items of such property and the person to whom each item is to be distributed. In the event no list is found or in the event there are items of such property not mentioned on a list, then such property or the omitted items shall pass as part of the remaining trust property disposed of hereinbelow.
>
> **d. DISTRIBUTION OF INCOME AND PRINCIPAL.** The Successor Trustee shall divide the remaining trust property (including any additions thereto, any income added to principal and any undistributed income) into equal shares, one for each of the Settlor's then living children and any deceased child of the Settlor who has left then living issue. Each share so created shall be held, administered and disposed of under the following terms and provisions[.]

The decedent subsequently amended the trust four times. Each amendment included a paragraph "**1.**" containing the modification and a paragraph "**2. AFFIRMATION OF TRUST**" stating that "[t]he Trust is hereby ratified and affirmed as amended herein." Only the third amendment, made in August 2017, modified paragraph 7. That amendment provided that the decedent's real estate in Lancaster County, Nebraska (the residence), be distributed to Miller. The amendment stated:

> **1. CHANGE IN DISPOSITIVE PROVISIONS**. Prior to making any distributions in accordance with paragraph 7.d. of the Trust Agreement, Settlor's home ... owned by this trust shall be distributed outright to ... **Miller** but only in the event that she is living in such home at the time of

> Settlor's death. The legal description of the home is ... Lancaster County, Nebraska.

The court held this language amounted to a pay from residue provision:

> In *In re Estate of Shell*, [*In re Estate of Shell*, 290 Neb. 791, 862 N.W.2d 276 (2015).] we considered whether the language in a will supplanted the statutory pattern regarding inheritance taxes. The paragraph at issue there contained two sentences. The first sentence authorized the personal representative " 'to pay from the principal of my residuary estate ..., all of my debts [and] all of the expenses of the administration of my estate.' " The second sentence authorized the personal representative " 'to pay from my probate estate, without contribution or reimbursement from any person, all inheritance, legacy or estate taxes ....' "
>
> In *In re Estate of Shell*, we concluded that the paragraph clearly showed an intent to treat inheritance taxes as an expense of the estate. We noted that the second sentence expressly referred to inheritance taxes and directed that they be paid from the probate estate, and we stated that courts generally have determined that language directing payment of estate and inheritance taxes exonerates the beneficiaries of their tax burden. We further observed that the second sentence immediately followed a direction in the first sentence to pay the testator's debts, expenses of his funeral, and expenses of the administration of his estate. We reasoned, "Coupling a direction to pay estate and inheritance taxes with a direction to pay the testator's debts, funeral expenses, and administration costs shows the testator's intent to pay the taxes off the top."
>
> Similar reasoning applies here. Paragraph 7.a. instructed the trustee to "pay from this trust all inheritance and estate taxes," whether on trust property or not. The next subpart, paragraph 7.b., directed the trustee to pay expenses and debts. Like in *In re Estate of Shell*, these instructions to pay the taxes and debts demonstrated the decedent's intent that the taxes be paid "off the top." Further, the third amendment specified that the residence be "distributed outright" to Miller and that it be done before dividing the remaining trust property. We conclude the language of the trust clearly showed that the decedent wished to shift the burden of the inheritance tax from the beneficiaries.
>
> The children contend that the trust and amendments require that *all* the trust's assets—not just the residue—be used to pay the taxes described in the trust. We do not believe that this is consistent with our decision in *In re Estate of Shell*, nor that it is a reasonable interpretation of the documents here. We therefore affirm the decision of the county court.

10. **<u>Trust Construction Under Nebraska Law</u>**. <u>In re Eileen Ryan Revocable Trust</u>, __N.W.3d ___ (NE 2024) involved testamentary trust distributions the amount of which were tied to amounts received during lifetime. The opinion reviews the clauses at issue:

> On October 19, 2007, Eileen executed the "Third Amended and Restated Trust Agreement" (Trust Agreement) that created the Eileen Ryan Revocable Trust. The Trust Agreement used a marital and family trust arrangement such that if Eileen predeceased her husband, Wayne L. Ryan, her assets would be divided into "marital" and "family" shares. The marital and family shares would then be further divided into subtrusts. The assets would be held in subtrusts for the remainder of Wayne's lifetime, with provisions for distribution of income or principal under certain circumstances.

Eileen died in 2013, at which point the Eileen Ryan Revocable Trust was created and funded. This proceeding concerns a portion of the Trust Agreement governing the Eileen Ryan Marital Trust (Marital Trust) that bequeathed $5 million in Countable Assets to each of Eileen's children. Eileen and Wayne had five children: Constance, Timothy Ryan, Stacy Ryan, Carol Ryan, and Steven Ryan (collectively the children). Only the Countable Assets provision in the Marital Trust is specifically at issue in this case, and we sometimes refer to the provision at issue as falling under the Trust Agreement for ease of reference.

***

Below, we set forth relevant portions of the Trust Agreement concerning the Countable Assets included in Eileen's bequests to each of the children. Section 9(e)(i) of the Trust Agreement provided that the amount distributed to a particular child of the settlor would be "[the] amount, if any, as needed at the time of the death of the survivor of Settlor and Settlor's husband to give [$5 million] in Countable Assets (as defined below) to each of Settlor's children." Section 9(e)(i) explained that

> [t]o the extent that the Wayne L. Ryan Revocable Trust Agreement contains a similar bequest, the total of such bequests per child shall be [$5 million] and, to the extent assets are available within the Wayne L. Ryan Revocable Trust, shall be satisfied first pursuant to the Wayne L. Ryan Revocable Trust Agreement.

Countable Assets were defined in section 9(e)(i)(1) as follows:

> "Countable Assets" for purposes of computing this [$5 million] shall include any amount(s) currently distributable to a child pursuant to other provisions of the Eileen Ryan Revocable Trust or the Wayne L. Ryan Revocable Trust, *any amount passing to Settlor's children pursuant to any Irrevocable Trust which either Settlor and/ or Settlor's husband have established during their lifetimes*, and any amounts passing automatically to any of Settlor's children by reason of either of the deaths of Settlor and/or Settlor's husband by virtue of beneficiary designation, survivorship, payable on death transfer or joint title (or joint ownership). Countable Assets shall also include any assets, at their current values, from any of the above sources even if not currently distributable to such child if the only reason such amounts are not currently distributable is because the beneficiary has not reached a required age for distribution. Any debt owing to Settlor by a child, as evidenced by a promissory note or other loan documentation, shall be extinguished and the amount of remaining unpaid principal and accrued interest, if any, otherwise due and owing to Settlor shall count toward such [$5 million] for such child.

(Emphasis supplied.)

The Trust Agreement was written and updated several times. The final and controlling version was made on October 19, 2007, and the Countable Assets provision contained in the Marital Trust remained substantially the same as it was in a 2004 version of the Trust Agreement. In the 2007 Trust Agreement, the residuary from the bequest of Countable Assets would be split one-half to the Ryan children and one-half to The Ryan Foundation.

***

> In July 2007, Eileen and Wayne each implemented GRATs funded by Streck, Inc., shares. The record shows that GRATs are a type of irrevocable gifting trust that allow a grantor to pass wealth to the next generation with little or no gift tax cost. GRATs allow a grantor to transfer property to a beneficiary while retaining the right to an annuity from the transferred property. *Badgley v. U.S.*, 957 F.3d 969 (9th Cir. 2020). The grantor creates an irrevocable grantor trust for a fixed term of years, transfers assets into it, and designates trustees and beneficiaries. *Id.* The grantor receives an annuity for a specified term of years. *Id.*
>
> In earlier proceedings in this case, and prior to Constance's present petition, the county court made a specific finding that each of the children had received 2,665,346 shares of Streck from the GRATs of Eileen and Wayne. At that time, the court valued the shares of each child at $7,383,008.

Constance appeared to be motivated at least in part, by apparent statements her mother made about all this:

> Constance argues that since a personal representative may lack standing to challenge an order of distribution, or appeal the distribution of a probate estate, see 34 C.J.S. *Executors and Administrators* § 673 (2022) and *In re Estate of Craig*, 101 Neb. 439, 163 N.W. 765 (1917), then it follows that he or she would not be allowed to participate in an action to declare rights under a trust. We do not agree.

The court did not find the trust ambiguous or that there was evidence Eileen was under a mistaken belief about the law or facts

11. <u>Trust Investments Where Prudent Investor Rule Waived</u>. <u>Redlin v. First Interstate Bank as Co-Trustee of Helen M. Redlin Trust, u/t/d/ December 14, 2004</u>, 2024 WL 374705 (S.D. 2024), dealt with whether co-trustees breached their fiduciary duties by keeping a substantial portion of the trust assets in cash. The opinion states:

> On December 14, 2004, Helene M. Redlin established a trust of last recourse (2004 Trust), designed to provide for her children if their other financial resources failed. In addition to a small amount of cash and an interest in the Helene Redlin Limited Partnership, the 2004 Trust assets included a $3 million life insurance policy on Helene. Upon Helene's death, any assets over $3 million were to be distributed to the Terry A. Redlin and Helene M. Redlin Dynasty Trust. Her daughters, Kim and Kelly, could then, at the discretion of the trustee, receive income and principal distributions from the remaining assets "for their health, support and education, taking into consideration their other financial resources of any kind." In the event of Kim and Kelly's deaths, Helene's son Charles could also receive income and principal distributions from the 2004 Trust under identical conditions. Any assets remaining after the death of Helene's children would be gifted to the Redlin Art Center.
>
> Charles, Kelly, and Kim are also the beneficiaries of two other family trusts. The Helene M. Redlin Grantor Trust, established in 2017, is split into three subtrusts of $11.6 million for each of Helene's children. Charles, Kelly, and Kim also received $1 million each through another trust established in 2000. These funds were distributed to Charles, Kelly, and Kim without consideration for their interest in the 2004 Trust.
>
> ***

Article XI, Section A of the 2004 Trust grants specific powers to trustees, including the ability to "open and maintain one or more savings accounts or checking accounts and ... deposit to the credit of such account or accounts all or any part of the trust property, irrespective of whether such property may earn interest." In the event of multiple co-trustees, Article XI, Section O provides that decisions are to be made by majority vote, with unanimity required where only two co-trustees are qualified to vote. Article XI, Section K of the 2004 Trust also waives the Prudent Investor Rule:

> In exercising the investment powers conferred above, the trustee may (but is not directed to) acquire or continue to hold any property received by the trustee, even though not of a kind usually considered suitable for trustees to acquire or hold (including investments that would be forbidden by the "prudent investor rule" or the "prudent person rule," as may be applicable ...), or even though an investment may constitute a larger proportion of the trust than, but for this provision, would be appropriate, and irrespective of any risk, nonproductiveness, or lack of diversification.

At the end of this waiver, Helene made explicit her intent to "grant the trustee the broadest possible discretion in determining what constitutes an appropriate investment, acceptable level of risk and proper investment strategy, consistent with his fiduciary duties."

***

Helene died in January 2020 and life insurance proceeds of $3 million were distributed to the 2004 Trust. The assets were then placed in a money market account at Kovack Securities, a Florida financial firm. As required by the terms of the 2004 Trust, assets in excess of $3 million were distributed to the Terry A. Redlin and Helene M. Redlin Dynasty Trust in October 2020. From March 2020 to April 2021, the money market account yielded $843.23 in interest. Learning of this rate of return, Kelly retained Paul Freidel, a financial expert, to assess the economic damage to the 2004 Trust while it was held in the low interest money market account. Freidel opined that if the $3 million in trust assets were aggressively invested from March 31, 2020 through December 31, 2021, the 2004 Trust would have reaped a total investment return of $2,388,768.

Based on this information, Kelly filed suit against Charles and First Interstate, alleging breach of fiduciary duty and seeking their removal as trustees. Kelly argued that Charles and First Interstate were both co-trustees and that they had breached their fiduciary duties by failing to invest the trust assets more aggressively. Despite Helene's waiver of the Prudent Investor Rule, Kelly claimed that Charles and First Interstate remained liable for investment decisions made unreasonably or in bad faith under SDCL 55-4-30. To support this claim, Kelly relied upon Freidel's affidavit, which concluded that placing the 2004 Trust assets in a money market account was "egregiously unreasonable given the low-interest rate environment during this time period and the fact that [the 2004 Trust] ... was not expected to be tapped for a considerable length of time."

The court upheld the actions of the co-trustees as clearly as it possibly could:

> Preliminarily, we note that, since no Investment Advisor has been appointed, investment powers and responsibilities are entrusted to the trustees by Article IV, Section B. Article XI, Section K also purports to waive the Prudent Investor Rule

and “grant the trustee the broadest possible direction in determining what constitutes an appropriate investment.”

Notwithstanding this apparent waiver, Kelly argues that there is a statutory “floor [for liability] beneath which the governing trust instrument cannot go.” In support of this proposition, she cites SDCL 55-4-30, which provides that “[a] provision of a trust instrument relieving a trustee of liability for breach of trust is unenforceable to the extent that it relieves the trustee of liability for breach of trust committed in bad faith or as a result of gross negligence.” Kelly further asserts that “SDCL 55-5-12 allows the settlor to expand, restrict, eliminate, or otherwise alter the investment responsibilities imposed on a trustee but further provides that a trustee remains liable for actions that are unreasonable or taken in bad faith.” According to Kelly, “while Charles and the Bank may not be held to the Prudent Investor Rule they nonetheless remain liable ... if they have engaged in gross negligence or bad faith.”

Charles and First Interstate respond that their reasonable reliance on the waiver, which explicitly allows for “nonproductive” investments, precludes any liability for the supposed lost investment income. First Interstate also argues that the gross negligence contemplated in SDCL 55-4-30 requires allegations of misconduct much more serious than the conservative investment strategy at issue here. First Interstate points out that, by Kelly's own account, the 2004 Trust assets did produce income in the money market account, albeit much less than she would have preferred.

We have not yet been asked to interpret the terms of SDCL 55-5-12, which provides that “[t]he provisions of this chapter may be expanded, restricted, eliminated, or otherwise altered by express provisions of the trust instrument. The trustee is not liable to a beneficiary for the trustee's reasonable and good faith reliance on those express provisions.” Kelly seems to argue that, while this statute may permit waiver of the Prudent Investor Rule, it also creates liability for “actions that are unreasonable or taken in bad faith.” However, the statutory text focuses not on the conduct of the trustee, but rather on the trustee's “reliance on [the] express provisions” of a trust. Thus, the statute focuses our attention on whether a trustee's actions were based on a good faith, reasonable interpretation of the trust documents.[1]

Here, the 2004 Trust specifically waives the Prudent Investor Rule, authorizing trustees to make investment decisions “irrespective of any risk, nonproductiveness, or lack of diversification.” Article XI, Section A gives trustees the power to “open and maintain one or more savings accounts or checking accounts and ... deposit to the credit of such account or accounts all or any part of the trust property, irrespective of whether such property may earn interest.” Helene declared in Article XI, Section K that it was her intent to “grant the trustee the broadest possible discretion in determining what constitutes an appropriate investment.”

Here, the undisputed facts reveal no evidence that Charles’ and First Interstate's reliance on these provisions was unreasonable or in bad faith. Charles and First Interstate were specifically authorized to make investment decisions regardless of risk or nonproductivity of the investment. By placing the 2004 Trust assets in a money market account, yielding conservative interest income, the co-trustees were operating as authorized. Freidel's after-the-fact conclusion that this decision was “egregiously unreasonable” does not generate a question of fact regarding whether the co-trustees were reasonably relying on the 2004 Trust provisions.

> There is also no indication that Charles or First Interstate operated in bad faith or had ulterior motives that would call their actions into question.
>
> However, Kelly argues that, even if the Prudent Investor Rule was waived, SDCL 55-4-30 creates an alternative source of liability. According to the statute, "[a] provision of a trust instrument relieving a trustee of liability for breach of trust is unenforceable to the extent that it relieves the trustee of liability for breach of trust committed in bad faith or as a result of gross negligence." The circuit court determined that this provision did not apply because "the terms of the 2004 Trust merely restricted Charles's duty to invest but did not eliminate it." However, we do not read the statute to apply only where a duty has been entirely eliminated. The statute centers on whether an instrument relieves a trustee of liability "to the extent" of bad faith or gross negligence. Regardless of whether a duty is limited or eliminated, the statute, acting as a liability floor, will render a waiver partially invalid *to the extent* it shields trustees from liability for bad faith or gross negligence. We thus conclude that SDCL 55-4-30 prevents the 2004 Trust from waiving liability for gross negligence and bad faith and that Charles and First Interstate remain liable for any such potential misconduct.2
>
> ***
>
> Charles and First Interstate were not required to invest the money in any particular way under the 2004 Trust documents. Indeed, they were authorized to do exactly what they did—keeping the entirety of the trust assets in a checking or savings account, irrespective of the rate of interest. We also note that the 2004 Trust was designed as a last recourse for Helene's children should all other financial resources fail. Charles and First Interstate did not commit willful or wanton misconduct by keeping the assets in a conservative money market account, earning modest but consistent interest income without any risk from the inherent volatility of the stock market.
>
> Kelly's bare assertions of gross negligence and bad faith invite us to engage in speculation as to the co-trustees' intentions and decision-making process. But speculation cannot save Kelly from summary judgment where, as here, none of the proffered factual allegations would be sufficient to establish a breach of fiduciary duty at trial. Though our summary judgment standard requires us to draw all reasonable inferences in favor of the non-moving party, there must be some evidence from which a favorable inference may be drawn. We therefore conclude that Charles and First Interstate were entitled to summary judgment in that they did not breach their fiduciary duties under either the 2004 Trust or SDCL 55-4-30 by investing the assets in a money market account. Since this determination is dispositive, it is unnecessary to address whether First Interstate was a general trustee.

This sort of issue is reasonably common. Where the trust does seem to be "of the last resort" the result goes down easier than in circumstances were a trustee seems neglectful, lazy, or self-interested.

12. Termination of Charitable Trust Just To Avoid Trust Fees Not Allowed Under Pennsylvania Law. In 1965, Mr. Wells created a charitable trust for the Virginia Military Institute. Through various mergers, PNC Bank is now trustee, the trust in 2020 was worth $2.1 million, distributes the income to VMI of +/-$70,000, and paid trustee and accounting fees of +/- $20,000 a year. In In re Trust B Under Agreement of Richard H. Wells Dated September 28, 1956, 2024 WL 1201265 (Pa. 2024), the issue was whether the trust assets could be distributed to VMI at a savings of roughly $13,000 per year after investment fees were paid by VMI. PNC said no, and the Pennsylvania attorney general agreed that it should not be. The court concluded that merely to save fees was an inadequate rationale for trust termination under Pennsylvania's version of the UTC. VMI was not arguing that the fees were too high, or the performance too low. The court seemed focused on the settlor understanding that trusts had fees. Presumably the attorney general was focused on protecting investment services in Pennsylvania.

Charitable trusts should allow the charitable beneficiary to remove and replace the trustee. That keeps fees, service, and performance "in line." Further, a charity may find a trustee that would resign voluntarily.

13. **<u>No Alternate Taker Means Intestacy Under Maine Law</u>**. <u>Estate of Giguere</u>, ___ A.3d ___ (Me 2024), involves fascinating facts. The decedent, Linda Giguere, died leaving a Will that provided in pertinent part as summarized by the court:

> If my husband, WILLIAM D. GIGUERE, is deemed to have survived me, all the rest, residue and remainder of my estate, whether real, personal, or mixed, including the proceeds of any life insurance which may become payable to my estate, I give, devise and bequeath to ERIC GIGUERE, presently of Westbrook, Maine, as Trustee for my husband, WILLIAM D. GIGUERE, hereinafter "WILLIAM." ... The trustee may, in his sole discretion, amend this trust to conform with changes in federal or state law or regulations established thereunder in order to better effect the purposes of the trust. ...
>
> MARK GIGUERE shall be trust protector.
>
> ....
>
> Upon WILLIAM's death, the Trustee may pay the expenses of his last illness and funeral, and all administrative expenses relating to this Trust, including reasonable attorneys' and accountants' fees .... Whatever balance is then remaining shall be paid to WILLIAM's children, in equal shares, the children of a deceased to take the parent's share by right of representation.
>
> Article Seven of the 2013 will provided as follows:
>
>> I have in mind all other possible recipients of my bounty, including my daughter, HILARY BARLOW, from whom I am estranged, but unless I have specifically mentioned them herein, to them I leave nothing.

William died six years before Linda, so there is no trust. Not surprisingly, Hilary thought she should inherit via intestacy, a contention disputed by William's two sons, Eric and Mark. The attorney for the estate filed a petition for instruction that asserted the Will contained a scrivener's error because Linda clearly didn't want Hilary to take but named no one else. So they asked the lawyer who prepared the Will, which resulted in evidence the opinion described as follows:

> On March 22, 2023, the parties deposed Attorney Susan Hunter, whom Linda and William had consulted for estate planning advice and who had drafted several wills for them, including Linda's 2013 will. Attorney Hunter first prepared wills for Linda and William in March 2011. By 2012, William's health was

> deteriorating. Attorney Hunter prepared revised wills for Linda and William in 2012 to reflect several requested changes in their estate plan, including the establishment of reciprocal special needs trusts. Linda's 2012 will, executed on July 6, 2012, provided that if William survived her, the remainder of her estate (excluding tangible personal property which was separately devised) would go to a trust for William's benefit. Her 2012 will designated William's son Eric as trustee and provided that upon William's death, "[w]hatever balance is then remaining" in the trust would pass to Linda's daughter, Hilary. It further specified that if William predeceased Linda, the remainder of her estate was to pass to Hilary.
>
> In January 2013, Linda contacted Attorney Hunter and said that she wanted to omit Hilary from her will. Attorney Hunter made the requested change by inserting the language in Article Seven, quoted above. When Attorney Hunter asked how Linda wanted to dispose of the remainder of her estate in the event William predeceased her, Linda said that "she wasn't ready to make a decision and so she said we'll deal with that later." Attorney Hunter distinctly understood at the time that "[Linda] wasn't ready" to designate a recipient of her residuary estate in the event that William predeceased her. Attorney Hunter did not recall having a discussion with Linda about the consequences of failing to designate a residuary devisee in the will or how intestate succession operated under Maine law. Attorney Hunter was certain, though, that it was Linda's intention at the time not to include a provision in the 2013 will disposing of her residuary estate in the event that she survived William and that the absence of such provision was not a scrivener's error.

Eric and Mark argued that Ms. Hunter's testimony was self-serving and unreliable, a contention the court rejected:

> The court found—and the record does not compel a finding to the contrary—that when executing the 2013 will, Linda did not intend for Eric and Mark to be residuary devisees in the event that she survived their father. The unrebutted deposition testimony of Attorney Hunter established that Linda was aware that the 2013 will did not provide for the disposition of her residuary estate if William predeceased her. Linda acknowledged that she "wasn't ready to make [that] decision" and preferred to "deal with that later."
>
> Further, not only did Eric and Mark fail to meet their burden of proving by clear and convincing evidence the very premise of their reformation request—that the omission of a residuary clause in the 2013 will was a scrivener's error—but the record squarely contradicts that assertion. Attorney Hunter, the individual who prepared the 2013 will, testified unequivocally that the omission was not a scrivener's error. It was purposeful because Linda was not prepared at that time to name a devisee. This is further supported by the fact that Linda's 2012 will *did* name a residuary devisee in the event that Linda survived William, indicating that she was likely aware of the need for, and function of, such a provision.
>
> Eric and Mark challenge Attorney Hunter's credibility and posit that her testimony was self-serving. The court, however, expressly found that Attorney Hunter was an "experience[d] counsel" in this area. More importantly, there is no compelling evidence in the record to support the claim that Attorney Hunter had testified untruthfully.

14. **Cattle and Related Assets Marital Property in Oklahoma**. In the Matter of the Estate of Teddy Lee Applegate, Deceased, ___P.3d ___ (Ok. 2024), dealt with a simple issue: where a decedent raised cattle before and after marriage, was the cattle operation marital property? The court held it was. The opinion states:

> No one disputes that Teddy's livelihood before the marriage involved buying, raising, and selling cattle, that he had assets related to this endeavor when he married Charlene, and that he continued ranching for the rest of his life. Nor is there any dispute that all of the cattle in existence at the time of Teddy's death were acquired during the marriage. Appellants claim that because Teddy entered the marriage with cattle, and the couple owned cattle at the time of Teddy's demise, the existing cattle necessarily relate back to the original herd, and it was Charlene's burden to prove that Teddy intended to transform the business into marital property. They demand that Charlene "show receipts," as it were, to document the value (if any) that she added to the business during the marriage. Charlene, however, contends that she and Teddy intended the raising of cattle to be a joint endeavor, and that all of the evidence supports a conclusion that the cattle and hay are marital property.
>
> The income or increase of separate property owned prior to marriage, which accrues without the aid or effort of the non-owning spouse after marriage, retains its nature as separate property. *See e.g. In re Pierce's Estate*, 1932 OK 757, ¶ 13, 161 Okla. 94, 17 P.2d 411, 412; *In re Wagner's Estate*, 1936 OK 724, ¶ 10, 178 Okla. 384, 62 P.2d 1186, 1189-1190. Thus, offspring of separate property livestock presumptively retains its character as separate property. But the initial burden of proof is upon the party claiming the increase should be considered separate property to establish that the subject livestock are, in fact, offspring of livestock that was treated during the marriage as separate property.
>
> The record before us fails to identify the specific cattle that may or may not be the offspring of separate property livestock. In fact the record affirmatively sets forth a clear pattern of both commingling and enhancements contributed by Charlene. Well before he and Charlene formally married, Teddy treated ranching as a joint effort. That change is evidenced by how the couple titled their bank accounts, how they commingled cattle-related income and expenses with personal income and expenses, and how they both contributed time and effort to raising cattle. The commingling of assets for joint use and enjoyment is reasonably viewed as a contribution to the marital estate. *Owens v. Owens*, 2023 OK 12, ¶ 37, 529 P.3d 905, 916.
>
> Appellants claim that the buying and selling of cattle over the years was nothing more than a change in the *form* of Teddy's separate property, an "exchange" from cattle to cash and cash to cattle. *See Reynolds v. Phipps*, 1923 OK 159, ¶ 10, 89 Okla. 21, 213 P. 855, 857 (separate property does not lose its separate character merely because it changes form). This characterization ignores two important facts. First, any such "exchanges" were accomplished through a jointly-held bank account. Funds related to the purchase, care, and sale of cattle were commingled with those used for the couple's general expenses. This commingling supports an inference that Teddy intended to share his ranching endeavors with Charlene. *See Standefer*, 2001 OK 37 at ¶ 16, 26 P.3d 104 (spouses commingled separate personal-injury settlements to create a single marital asset); *Umber*, 1979 OK 24 at ¶¶ 11-12, 591 P.2d 299 (husband commingled funds from sale of his pre-marital business with wife's separate funds to start new business that was marital property); *compare Mothershed v. Mothershed*, 1985 OK 23, ¶¶ 11, 18-19, 701 P.2d 405, 408, 410 (stock shares were wife's separate property where they

were given to her in her name only, and she maintained them separately during marriage).

Appellants also fail to appreciate the nature of the particular assets here. To be sure, ranching was Teddy's livelihood — and apparently the couple's only livelihood. But we are presented with no evidence that it was a discrete business entity. We are not dealing with shares of corporate stock; we are dealing with livestock and hay. Cattle cannot be stored in a safe-deposit box. Unlike jewelry or cash, they require land, water, feed, medicine, and other supplies. Unlike a certificate of deposit or savings bond, they do not mature by themselves. The very existence of livestock and crops depends on efforts unlike those needed for many other assets. *See Elder v. Elder*, 824 S.W.2d 520 (Mo.App. 1992) (cattle born during couple's marriage were marital property, even if they were offspring of cattle that one spouse owned before the marriage); *In re Marriage of Williams*, 639 S.W.2d 236 (Mo.App. 1982) (same).

The cattle Teddy owned when he married Charlene are long gone. The herd that existed at his demise was purchased with commingled funds and cared for by joint efforts. The record shows that during their marriage, Teddy and Charlene treated cattle ranching as a joint effort. The trial court's ruling is not against the clear weight of the evidence.

15. **<u>Domicile Determination Under Wyoming Law</u>**. In <u>Matter of Estate of Tokowitz</u>, 541 P.3d 446 (Wy. 2024), Neal Tokowitz died having executed a Will that states he was a married man domiciled in Park County, Wyoming. The decedent's wife filed in Wyoming for a statutory share of his estate and the executor and trustee of the pourover trust argued that she had to show proof of domicile. The Wyoming Supreme Court said the statement in the Will shifted the burden back to the estate.

16. **<u>Montana Supreme Court Does Not Accept Video Will For Probate</u>**. <u>In the Matter of the Estate of Beck</u>, _________________ (MT. 2024), dealt with sad facts described by the court as follows:

On July 15, 2022, Jesse crashed his motorcycle on Highway 212 in Carbon County, Montana. While Jesse was receiving help on the side of a road from another driver, a Carbon County Sheriff's Office deputy, who was responding to the report of Jesse's accident, tragically struck and killed both Jesse and the other driver. Jesse was survived by his only child, Alexia Beck (Alexia).

Four days prior to his death, Jesse had sent Jason a phone video recording of himself, in which Jesse stated:

> I, Jesse Beck, give all my possessions, if anything happens to me whatsoever, I give all my possessions, everything, to Jason Beck, my brother. Christina Fontineau does not get one thing, not one thing.

Limited detail about the circumstances surrounding the video, other than its delivery to Jason's cellphone, is set forth in the record. No witnesses appear or are apparent in the recording, and Jesse's words were not reduced to written form and signed by Jesse. Christina Fontineau is stated to be a nonrelative who would not be entitled to take from Jesse's Estate (the Estate) under the laws of intestacy.

Following Jesse's death, Alexia filed a petition for informal appointment as personal representative in intestacy to administer the Estate, which was ordered

> on July 26, 2022. She also initiated a wrongful death action in connection with the accident in which Jesse was struck and killed. In October 2023, Jason filed a complaint seeking intervention in the wrongful death action, a petition for formal proceedings to probate Jesse's video recording as an enforceable will, which he argued would make him the sole devisee, and for appointment as personal representative of the Estate and removal of Alexia as personal representative. Alexia filed an objection, arguing the video did not qualify as a will under statute.

Montana has a normal statute requiring that a will be in writing, but also has another provision that bears on this situation:

> **Writings intended as wills**. Although a document or writing added upon a document was not executed in compliance with 72-2-522, the document or writing is treated as if it had been executed in compliance with that section if the proponent of the document or writing establishes by clear and convincing evidence that the decedent intended the document or writing to constitute:
>
> (1) the decedent's will;
>
> (2) a partial or complete revocation of the will;
>
> (3) an addition to or an alteration of the will; or
>
> (4) a partial or complete revival of the decedent's formerly revoked will or of a formerly revoked portion of the will.
>
> Section 72-2-523, MCA.
>
> Jason argues the use of the phrase "document or writing" within § 72-2-523, MCA, contrasts the "in writing" requirement for execution of wills under § 72-2-522, MCA, and "establishes the legislature's intent to allow non-written documents, such as video and audio recordings, to also qualify as intended wills." Noting dictionary definitions that incorporate electronic documents, and the statutory directive that the Uniform Probate Code (UPC) is to be "liberally construed and applied to promote its underlying purposes and policies," § 72-1-101(2)(a), MCA, Jason argues that construing § 72-2-523, MCA, "to include video recordings as 'documents' would further the purpose of honoring testamentary intent and promote justice."

The difficulty in this case was there was no document for the video to be added to. The court noted the general legislative landscape as well:

> The expansion of electronic media applications has resulted in proposed legislation to provide for and regulate their uses in commercial and legal affairs, but this has not extended to approval of a nonwritten, video will. In 2001, the Legislature enacted the Uniform Electronic Transactions Act (UETA) to "facilitate electronic transactions consistent with other applicable law" by allowing the use of electronic signatures. Section30-18-105, MCA. However, the Legislature limited the UETA, in the context here, by "specifically exclud[ing] from its scope laws 'governing the creation and execution of wills, codicils, or testamentary trusts.'" *Meyer v. Jacobsen*, 2022 MT 93, ¶ 30, 408 Mont.369, 510 P.3d 52 (citing § 30-18-103, MCA). In recent years, the Uniform Laws

> Commission (ULC) has produced the Uniform Electronic Wills Act (UEWA), for the purpose of "bring[ing] estate planning into the digital age by allowing the online execution of wills while preserving the legal safeguards to ensure a will's authenticity." *See* Unif. Elec. Wills Act (Unif. L. Comm'n2021), https://perma.cc/3ETG-FQRC, https://perma.cc/8KZF-M5HP. The Montana Legislature has not adopted the UEWA, but even so, the Act as proposed by the ULC still "requires a testator to make a will that is readable as text at the time the testator electronically signs the document," and the testator's signature must be witnessed by two witnesses who add their own electronic signatures. *See* Unif. Elec. Wills Act § 5(a)(1)-(2) (emphasis added). There has not been, in any state, legislative authorization of nonwritten, video wills, nor approval of such a will by any court applying the UPC.
>
> ***
>
> Jason relies upon cases such as *In re Estate of Horton*, but the "document" there approved by the Court of Appeals of Michigan was an unsigned electronic note on the decedent's phone that the decedent had referenced in a separate handwritten note and described as his "farewell," and which included his instructions about where to find his will. *In re Estate of Horton*, 925 N.W.2d 207 (Mich. App. 2018). The Court reasoned, applying Mich. Comp. Laws §700.2503, the same uniform provision as § 72-2-523, MCA, that "a will need not be written in a particular form or use any particular words; for example, *a letter or other document, such as a deed*, can constitute a will." *In re Horton*, 925 N.W.2d at 212(emphasis added). This ruling does not further Jason's statutory argument.

The law evolves slowly. Therefore, text remains key. Suppose that Jesse's video had been converted into a transcript and submitted to the court. Would that have been a document?

17. **<u>Colorado Decides Assets In An UTMA Account Are Not Marital Assets</u>**. <u>In re: Marriage of Nevedrova and Nevedrova</u>, 562 P.3d 445 (Co. Ct. App. 2024), dealt with an account that appeared to be a Uniform Transfer to Minors Account and in a case of first impression determined it was not a marital asset. The opinion notes other authority.

> Other jurisdictions interpreting the uniform act upon which our statute is based directly conclude that, in the context of a dissolution of marriage case, UTMA accounts are not marital property. *See Heitmeyer v. Arthur*, 2022-Ohio-4230, ¶ 30, 201 N.E.3d 1052 (Ct. App.) (citing unpublished Ohio decisions that have held that a custodial account under Ohio's UTMA is not marital or separate property); *In re Marriage of Kenney*, 137 S.W.3d 487, 490-91 (Mo. Ct. App. 2004) (accounts under Iowa's UTMA law were not marital property); *Guerrier v. Guerrier*, 155 N.C.App. 154, 574 S.E.2d 69, 70 n.2 (2002) (noting that in a separate domestic relations action, the court had improperly considered accounts owned by the parties' children under North Carolina's UTMA to be marital property); *In re Marriage of Hendricks*, 681 N.E.2d 777, 782 (Ind. Ct. App. 1997) (stock, which was the subject of an irrevocable gift to the parties' child under Indiana's UTMA, was not "marital property" that could be divided upon the dissolution of the parties' marriage).

On the facts, the court remanded for a determination whether the account was really an UTMA account.

18. Delaware Magistrate Would Dismiss Claims Against Spendthrift Trust. In the matter of the CES 2007 Trust, C.A. No. 2023-0925-SEM (Ch. Ct. DE. 2025), the Magistrate recommended dismissal of an action against the trustee of a Delaware spendthrift trust. The trust was established on April 30, 2007. The claims at issue arose, in Michigan, sometime between 2014 and 2018. The trust owns interests in LLCs and the grantor is the investment advisor. The Magistrate found that the terms of the trust met the Delaware asset protection trust statute, that the grantor was not the de facto trustee, just the investment advisor, and that there was no reason the trust should be set aside or the spendthrift clause voided.

19. Trust Not Amended By Questionnaire Answers Given to Lawyer in California. Trotter v. Van Dyck, 322 Cal.Rptr.3d 622 (Cal. App. 5th 2024), dealt with a revocable trust and the settlor's potential changes. The facts are all important:

> In late June 2020, Mary, Timothy, and Matthew Pribyl, Mary's estate planning attorney, exchanged e-mails about amending the Trust, excerpted below. On June 25, before her scheduled surgery on July 1, Mary e-mailed Timothy stating:
>
> > My mind is quite clear now as [to] how to move forward on the house and will.
> >
> > "I will write it out and then we need to see that the lawyer gets a copy asap and start redoing the will and trust.
> >
> > "1. The house will go to you
> >
> > "2. My cash assets will be divided among my five children; nothing to Wendy [¶] ... [¶]
> >
> > "The rest of selected items will be assigned to different children/grandchildren and I'm working on that list.
> >
> > "Thanks, mom"
>
> The next day, on June 26, 2020, Timothy e-mailed Pribyl and copied Mary. He told Pribyl that Mary "want [*sic*] to make some updates on her personal stuff" and that they were "working on getting the financials all up to date ...." Timothy asked whether Pribyl was "available to meet on Zoom or phone to discuss."
>
> Pribyl wrote in response: "Relative to any updates/amendments Mary wants to make to her Trust and/or companion estate planning documents, maybe we can schedule a phone conference either next week before the July 4th holiday, or that following week." Mary replied and told Pribyl that she would "be available to discuss the [Trust] and Will anytime on Monday or Tuesday of next week and then after the [*sic*] July 4th. [¶] If you have questionnaires regarding the changes, please forward to me ...."
>
> A few days later on June 29, 2020, Pribyl responded:
>
> > "Attached to this message is my Questionnaire/Estate Plan Data Sheet that you can use to indicate the changes you want to make to your Trust, Will, Health Care and Asset Powers of Attorney, etc.

> "And I will have time tomorrow ... if you want to discuss the changes by phone as well.
>
> > "But if you want to review the Questionnaire in greater detail, and then schedule a time to talk next week, that works for me too. I'll be in my office every day during the week beginning Monday, July 6th, so you can let me know a day and time that would work best for your schedule."
>
> Mary replied later that day: "Working on the questionnaire and will email tonight or tomorrow morning. We can decide then about what we may need to discuss."
>
> On June 30, 2020, Mary sent Pribyl a scanned copy of the questionnaire, which she completed by hand. Her cover e-mail said that the "estate planning questionnaire" was attached and "[t]his is something you can review before we talk .... Thanks, Mary[.]" The questionnaire, entitled "Client Estate Plan Data Sheet," included spaces for biographical information such as address, family members, personal property, bank information, and citizenship. Under "Dispository Plan," where the instructions say to "describe in detail" who should inherit her assets when she dies, Mary left that space blank. On the following page, in the section for listing "CHILDREN AND GRANDCHILDREN," Mary listed her children's names from present and prior marriages, including Van Dyck. Mary drew an asterisk next to Van Dyck's name and drew another asterisk at the bottom of the page with the words, "NO CONTACT – WOULD PREFER TO DROP FROM WILL – IF POSSIBLE[.]" On the next page, she drew asterisks next to certain lines in the "Stocks and Mutual Funds" section, and noted next to another asterisk in the footer: "1 SHARE APPLE – FOR [beneficiary J.] – DISCUSS ACCT FOR [beneficiary J.] ...."

Sadly, Mary never left the hospital and was unable to do more estate planning. The court first concluded that these electronic writings did not "count" because they were not within the ambit of the Uniform Electronic Transaction Act:

> We turn first to Timothy's argument that a trust amendment constitutes a transaction, bringing it within the UETA's purview. We consider the issue de novo. (*B.H. v. County of San Bernardino* (2015) 62 Cal.4th 168, 189, 195 Cal.Rptr.3d 220, 361 P.3d 319 ["The meaning and construction of a statute is a question of law, which we decide independently."].)
>
> The parties do not dispute that unless Mary is deemed to have signed the writings electronically, the writings were not otherwise "signed" as required by the Trust. The UETA provides that in certain contexts, an electronic record satisfies the requirement that a record be in writing (§ 1633.7, subd. (c)), and an electronic signature satisfies the requirement that the writing be signed (§ 1633.7, subd. (d)). (See *J.B.B. Investment Partners, Ltd. v. Fair* (2014) 232 Cal.App.4th 974, 987–988, 182 Cal.Rptr.3d 154; *Ni v. Slocum* (2011) 196 Cal.App.4th 1636, 1647, 127 Cal.Rptr.3d 620 ["the Legislature has, through these provisions, expressed general approval of the use of electronic signatures in commercial and governmental transactions"].) Importantly, by its own terms, the UETA only applies "to a transaction between parties each of which has agreed to conduct the transaction by electronic means." (§ 1633.5, subd. (b).) The UETA defines "transaction" as "an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs." (§ 1633.2, subd. (o).)

Even though Mary was both the trustor and trustee when she sought to amend the Trust, Timothy argues that the amendment was a transaction and not a unilateral exercise because the Trust requires both execution by the trustor *and delivery* to the trustee. (Prob. Code, §§ 15402 & 15401, subd. (a)(2).) We disagree.

" 'The goal of statutory construction is to ascertain and effectuate the intent of the Legislature. [Citation.] Ordinarily, the words of the statute provide the most reliable indication of legislative intent. [Citation.] When the statutory language is ambiguous, the court may examine the context in which the language appears, adopting the construction that best harmonizes the statute internally and with related statutes. [Citations.] " 'Both the legislative history of the statute and the wider historical circumstances of its enactment may be considered in ascertaining the legislative intent.' " ' " (*Haggerty v. Thornton* (2021) 68 Cal.App.5th 1003, 1008, 284 Cal.Rptr.3d 32.)

Assuming for the sake of argument that the phrase "two or more persons" can be fairly interpreted to include one person acting in two or more separate capacities, the context in which the language appears leads us to conclude that the purported trust amendment here would not constitute a transaction under the UETA. Both parties rely on commentary to the UETA from the National Conference of Commissioners on Uniform State Laws (also known as Uniform Law Commission or ULC), as did the probate court. We also consider the ULC's comments because when California adopted the UETA, the Legislature's intent was "to make uniform the law with respect to the subject of this title among states enacting it." (§ 1633.6(3).) According to those comments, the term "transaction" does not include "unilateral or non-transactional actions." (See Uniform Law Commission, Electronic Transactions Act (2021) <https://www.uniformlaws.org/viewdocument/final-act-21?CommunityKey=2c04b76c-2b7d-4399-977e-d5876ba7e034&tab=librarydocuments> [as of June 24, 2024], archived at <https://perma.cc/F2KD-TGY6>, UETA Final Act [downloadable PDF file], Comments to UETA, § 2, pp. 10–11, archived at <https://perma.cc/U9W9-NVU4>.) Importantly, after listing examples of what constitutes a transaction, the comments state that "[a] transaction must include interaction between two or more persons. Consequently, to the extent that the execution of a will, *trust*, or a health care power of attorney or similar health care designation does not involve another person and is a unilateral act, it would not be covered by this Act" because it is "not occurring as a part of a transaction as defined in this Act." (UETA Final Act [downloadable PDF file], Comments to UETA, § 2, p. 11, italics added, archived at <https://perma.cc/U9W9-NVU4>.)

The ULC comments make clear that the purported trust amendment in this case falls in the category of unilateral acts excluded from the UETA. As sole trustor, Mary had a right to amend the Trust by a unilateral act. The mere delivery of such an amendment to the trustee (herself) would not constitute a "transaction between parties" within the meaning of the UETA. (§ 1633.5, subd. (b).) Even if the trustee were someone other than Mary, transmitting such a unilateral amendment to the trustee would not constitute a transaction "occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs." (§ 1633.2, subd. (o).) Merely delivering a document to someone is no more of a "transaction" than sending someone a letter. Accordingly, we conclude that the UETA's electronic signature provisions do not apply to Mary's writings, and the probate court did not err in finding that neither the e-mails nor the attached questionnaire was properly "signed" to effectuate an amendment to the Trust.

Even if UETA had applied, the court would not have given effect to the amendment, because the questionnaire was not a clear plan.

20. **<u>Settlors Failed To Terminate Irrevocable Trust Under Pennsylvania Law</u>**. Suppose parents transfer their house and some financial assets to a trust for their own benefit and the benefit of their grandchildren Their intent is to protect the assets and to qualify for Medicaid. Subsequently, they discover the trust does not allow them to qualify for Medicaid, whereupon they seek to terminate the trust. Such were the facts in <u>Matter of Petterson Family Irrevocable Trust</u>, 333 A.3d 453 (PA Super. 2025). The court said no to termination:

> The issue presented is whether Appellants' mistaken belief at the time they formed the Trust, namely that they believed the Trust would preclude their residence from being used to satisfy healthcare claims under Medicaid, gives rise to an unanticipated circumstance such that the orphans' court is permitted to terminate the Trust under Section 7740.2(a). This issue appears to be one of first impression. For nearly two centuries, courts have held that "ignorance of the law furnishes no excuse to any person, either civilly or criminally; and, consequently, a mistake in law cannot be relieved against, either in equity or at law." *Good v. Herr*, 7 Watts & Serg. 253, 1844 WL 4989 (Pa. 1844); *see also First Nat'l Bank of Sunbury v. Rockefeller et. al.*, 333 Pa. 553, 5 A.2d 205, 206 (1939) (reiterating that, ignorance or mistake of law with a full knowledge of the facts cannot be grounds for relief); *Acme Mkts. v. Valley View Shopping Ctr.*, 342 Pa.Super. 567, 493 A.2d 736, 737 (1985); *Wilson Area Sch. Dist. v. Skepton*, 586 Pa. 513, 895 A.2d 1250, 1255 (2006); *Commonwealth v. Bradley*, 232 A.3d 747, 759 (Pa. Super. 2020). "[O]ne is presumed to know the law and [ ] to hold otherwise would render legal accountability unenforceable." *Valley View*, 493 A.2d at 737. "[T]o allow mistake or ignorance of the law to void actions taken by parties would subvert the effective administration of the law." *Id.*; *see also Bradley*, 232 A.3d at 759 (stating that, if mistake of law were accepted as providing grounds for relief, "it would provide an absolute defense to any prosecution where a defendant asserts a good-faith, yet erroneous, understanding of the law" (citation and original quotation marks omitted)). Our Supreme Court has defined "mistake of law" as "a mistake as to the legal consequences of an assumed state of facts." *Betta v. Smith*, 368 Pa. 33, 81 A.2d 538, 539 (1951). "A mistake of law occurs where a person is truly acquainted with the existence or nonexistence of facts, but is ignorant of, or comes to an erroneous conclusion as to, their legal effect." *Valley View*, 493 A.2d at 737 (citation omitted).
>
> In their petition to terminate the Trust, Appellants asserted that their "purpose in establishing the [T]rust was 'to protect the assets of the Trust' by rendering [the] assets of the [T]rust unavailable as an asset if [one or both of them] were to enter skilled nursing home care in the future and require application for public benefits, including [Medicaid]." Petition to Terminate Trust, 1/16/24, at ¶10. Appellants further averred that the trust agreement, as written, "ensures that the assets of the [T]rust will nonetheless be treated as an available resource if [one or both of them] requires application for Medicaid in the future." *Id.* at ¶12.
>
> Appellants' erroneous belief that the terms of the trust agreement exempted the Trust assets (their personal residence) from consideration for Medicaid eligibility, and shielded the asset from claims asserted under Medicaid, is a mistake of law. The "fact" is the existence of the trust agreement, as well as the terms set forth therein. Appellants' misunderstanding of the legal consequences of the trust agreement, and the terms contained therein, is a mistake of law. *See Valley View*,

> 493 A.2d at 737. Therefore, Appellants are not entitled to relief pursuant to Section 7740.2(a) as a result of their mistake concerning the legal consequences arising from creation of the Trust.
>
> Moreover, Section 7740.2(a) permits the orphans' court to terminate a trust if, because of unanticipated circumstances, termination would further the purpose of the trust. 20 Pa.C.S.A. § 7740.2(a). "Unanticipated circumstances" are circumstances to which no advance thought was given or that were not foreseen or expected. *See* https://www.merriamwebster.com/dictionary/anticipate (last visited Mar. 12, 2025). Appellants' mistake regarding the legal consequences of the trust agreement is not an unforeseen fact about the future, but, rather, a mistake in the legal effect and law concerning the Trust. Therefore, we discern no error of law or abuse of discretion in the orphans' court's denial of Appellants' petition to terminate the Trust.

21. Power of Appointment Renders A Trust Interest Revocable For Domestic Relation Purposes Under Colorado Law. Colorado allows a spouse's interest in a discretionary trust to be considered as an economic circumstance even if it is not a property interest. However, if the interest is amendable or revocable, it is not even an "economic circumstance. In In re Marriage of Smith and Butterworth, 559 P.3d 662 (Co. App. 2024), the trust involved gave wife's father a testamentary power of appointment. The court concluded such an interest was revocable:

> When dividing the marital estate, generally, the district court may consider a spouse's interest in a discretionary trust as an economic circumstance, even if it is not property. *Jones*, 812 P.2d at 1158; *Rosenblum*, 602 P.2d at 894; *see* § 14-10-113(1)(c). However, the court's consideration of a spouse's interest in such a trust may be limited by section 14-10-113(7)(b). This statute states,
>
>> "[P]roperty" and "an asset of a spouse" shall not include ... any interest under any donative third party instrument which is amendable or revocable, including but not limited to third-party wills, revocable trusts, life insurance, and retirement benefit instruments, nor shall any such interests be considered as an economic circumstance or other factor.
>
> *Id.*
>
> The family trust granted wife's father a power of appointment over the trust property upon his death. Her father could appoint the trust property outright or through a newly created trust, within his discretion.
>
> The district court found that any beneficial interest wife had in the trust was subject to this power of appointment. The court determined that it gave wife's father the power to dispose of the family trust property, which would in turn revoke wife's trust interest. The court then concluded that any interest wife had in the family trust was revocable and that section 14-10-113(7)(b) precluded the court from considering that interest.
>
> ***
>
> In 2001, a division of this court concluded that a vested remainder interest in a revocable or modifiable trust was a property interest. *In re Marriage of Gorman*, 36 P.3d 211, 213 (Colo. App. 2001), *superseded by statute*, Ch. 270, sec. 1, § 14-10-113(7)(b), 2002 Colo. Sess. Laws 1055, *as recognized in In re Marriage of Dale*, 87 P.3d 219, 224 (Colo. App. 2003). Following that decision, the legislature

enacted section 14-10-113(7)(b) to overturn that conclusion. *See Dale*, 87 P.3d at 224.

While *Gorman* addressed a revocable trust, the speakers in support of the amendment commented that enacting this statutory amendment would address the "revocable *interest* problem" and that it applied to "*anything* that can be revoked." Hearing on S.B. 02-160 before the S. Judiciary Comm., 63d Gen. Assemb., 2d Reg. Sess. (Mar. 20, 2002) (statements of Sen. Robert Hernandez and Ron Litvak) (emphasis added). Other comments made to the legislature further clarified that the amendment was intended to address "*interests* that can be revoked," Hearing on S.B. 02-160 before the H. Comm. on Civ. Just. & Judiciary, 63d Gen. Assemb., 2d Reg. Sess. (Apr. 25, 2002) (statement of Ron Litvak) (emphasis added), and that "the revocable *interest*" was the "heart of" the amendment, Hearing on S.B. 02-160 before the H. Comm. on Civ. Just. & Judiciary, 63d Gen. Assemb., 2d Reg. Sess. (Apr. 18, 2002) (statement of William Hunnicutt) (emphasis added). From all this, we glean that the legislature's concern was not just with revocable instruments, but any interest that is revocable. We therefore conclude that the legislature intended "revocable" within section 14-10-113(7)(b) to modify "any interest."

And when we review the other language within section 14-10-113(7)(b), this interpretation is supported by subsection (7)(b)'s repeated references to and focus on a spouse's interest. Indeed, it is the spouse's interest that is precluded from the court's consideration under this subsection. *Cf. Portercare Adventist Health Sys. v. Lego*, 2012 CO 58, ¶ 12, 286 P.3d 525 (construing statutory words and phrases together and in context). Moreover, the legislature's focus on the spouse's interest is consistent with the process by which the court determines whether a spouse has property subject to the court's allocation, which likewise analyzes the interest held by the spouse and its enforceability, not necessarily the instrument that happens to hold that interest. *See Cardona*, ¶ 12; *see also In re Marriage of Joel*, 2012 COA 128, ¶ 19, 404 P.3d 1251 (noting that we must construe the dissolution of marriage statutes in harmony where possible).

Moving then to the ordinary and natural meaning of "revocable," that term is defined as "[c]apable of being canceled or withdrawn." Black's Law Dictionary 1579 (11th ed. 2019); *see also Zander*, ¶ 13 (recognizing that when the legislature does not include a statutory definition, we may consult a recognized dictionary). Given this definition, section 14-10-113(7)(b) would preclude the court from considering any interest in a donative third party instrument as an economic circumstance or property if that interest is capable of being canceled or withdrawn.

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This conclusion is consistent with cases outside our jurisdiction. *See Noble v. Noble*, 2020 VT 105, ¶¶ 5, 8, 213 Vt. 583, 251 A.3d 541 (upholding the district court's conclusion that the wife's interest in an irrevocable trust could be eliminated by the wife's father's power of appointment); *S.L. v. R.L.*, 55 Mass.App.Ct. 880, 774 N.E.2d 1179, 1182 (2002) ("The wife's remainder interest in [the] trust was susceptible of complete divestment upon the wife's mother's exercise of the power reserved to her to appoint the remainder trust beneficiaries under the provisions of her will."); *In re Marriage of Beadle*, 1998 MT 225, ¶¶ 7, 9, 33, 37-38, 291 Mont. 1, 968 P.2d 698 (recognizing that a party's interest in a trust remained contingent until a power of appointment expired).

22. Attorney-in-Fact Amending A Trust Is The Exercise Of A General Power Of Appointment Under Virginia Law. The trust at issue in Kosmann, Trustee of Brown Living Trust v. Seamans, 903 S.E.2d 567 (Va. App. 2024), provided in pertinent part:

> Any right or power, other than (i) an amendment by Will, or (ii) any right or power that would constitute a general power of appointment if held by [Brown's] Attorney-in-Fact, may be exercised for and on [Brown's] behalf by any Attorney-in-Fact who, at the time of the exercise, is duly appointed and acting for [Brown] under a valid and enforceable Power of Attorney executed by [Brown]. Only if no such Attorney-in-Fact is then available may a legal representative appointed by a court of competent jurisdiction exercise such right or power.
>
> Other than as provided in this Section, [Brown's] powers under [this] Trust Agreement are personal to [Brown] and may not be exercised by any other person or entity.

The trust was otherwise an ordinary revocable, grantor trust. The settlor's attorney-in-fact amended the trust to make it irrevocable, to change trustees, and to somewhat modify the dispositive provisions. Two years later, having discovered the amendment, the other attorney-in-fact sued claiming those changes were invalid. The question was whether the amendment was the exercise of a general power of appointment:

> Kosmann contends that Monroe's Amendment did not constitute such a general power of appointment, and so did not violate the prohibition contained in Article 4, Section 4 of the Trust Agreement, proscribing an attorney-in-fact from exercising "[a]ny right or power that would constitute a general power of appointment."
>
> Kosmann's argument, in considerable part, turns on a trio of statutory definitions. First is the Uniform Trust Code's definition of "general power of appointment." The Code defines "general power of appointment" to "mean[ ] a power of appointment exercisable in favor of a powerholder, the powerholder's estate, a creditor of the powerholder, or a creditor of the powerholder's estate." Code § 64.2-701. Second is the Code's definition of "power of appointment." Such a power
>
>> enables a powerholder acting *in a nonfiduciary capacity* to designate a recipient of an ownership interest in or another power of appointment over the appointive property. *"Power of appointment" does not include a power of attorney.*
>
> Code § 64.2-701 (emphases added). Third, Kosmann points to the Uniform Power of Attorney Act, which defines "presently exercisable general power of appointment"
>
>> with respect to property or a property interest subject to a power of appointment, mean[ing] power exercisable at the time in question to vest absolute ownership in the principal individually, the principal's estate, the principal's creditors, or the creditors of the principal's estate. The term includes a power of appointment not exercisable until the occurrence of a specified event, the satisfaction of an ascertainable standard, or the passage of a specified period only after the occurrence of the specified event, the satisfaction of the ascertainable standard, or the passage of the specified

> period. *The term does not include a power exercisable in a fiduciary capacity or only by will.*

Code § 64.2-1600 (emphasis added).

As the italicized text emphasizes, the latter two terms, "power of appointment" and "presently exercisable general power of appointment," are not defined as to "include" fiduciaries and an attorney-in-fact. On this basis, Kosmann claims that, as a matter of statutory definition, a fiduciary, including attorneys-in-fact, cannot be such powerholders. Hence, Kosmann argues that because Monroe was Brown's attorney-in-fact, the Amendment did not constitute a "general power of appointment," since it is impossible, by statutory definition, for a "power of appointment" to be exercised by someone operating with a power of attorney.

> *A. Kosmann misconstrues the definitions of "power of appointment" and "presently exercisable general power of appointment" under Code §§ 64.2-701 and 64.2-1600.*

Kosmann's argument fails for two reasons. First, Kosmann's argument fails as a matter of pure statutory construction. Neither the definition of "power of appointment" in Code § 64.2-701, nor the definition of "presently exercisable general power of appointment" in Code § 64.2-1600, contains a categorical exclusion that forbids agents from exercising powers of appointment. Instead, what the statutes make clear is that both terms—"power of appointment" and "presently exercisable general power of appointment"—are not *coextensive* with the powers of a fiduciary or an attorney-in-fact.

***

Nonetheless, as noted, Code § 64.2-701 contains no prohibition preventing an attorney-in-fact from being authorized to exercise a power of appointment. Although a somewhat paradoxical result, it is conceivable that, under Virginia law, someone operating with a power of attorney could exercise a power of appointment. *See* Code § 64.2-751(E) ("A settlor's powers with respect to revocation, amendment, or distribution of trust property may be exercised by an agent, acting in accordance with § 64.2-1612, under a power of attorney that expressly authorizes such action except to the extent expressly prohibited by the terms of the trust."); *see also, e.g.*, *Stafford v. Crane*, 382 F.3d 1175, 1183 (10th Cir. 2004) ("The general weight of authority suggests that the power to create, modify, or revoke a trust is personal and non-delegable to an attorney-in-fact unless expressly granted in the power-of-attorney."). However, in exercising a power of appointment, an attorney-in-fact would still be bound to (i) "[*a*]*ct in accordance with the principal's reasonable expectations to the extent actually known by the agent* and, otherwise, in the principal's best interests"; (ii) "[a]ct in good faith"; and (iii) "[*a*]*ct only within the scope of authority granted in the power of attorney.*" Code § 64.2-1612(A) (emphases added). In ****576** other words, an authorized attorney-in-fact would still need to exercise the power consistent with its terms—a constraint that governs all such powerholders.

Similarly, although a presently exercisable general power of appointment under the Uniform Power of Attorney Act "does not include a power exercisable in a fiduciary capacity," Code § 64.2-1600, an attorney-in-fact may nevertheless, under the Act, hold a presently exercisable general power of appointment, so long as the power of attorney does not provide otherwise, and there is "language in [the] power of attorney granting general authority with respect to estates, trusts, and other beneficial interests." *See* Code § 64.2-1632(B)(3). Hence, although a

> presently exercisable general power of appointment "does not include a power exercisable in a fiduciary capacity," an attorney-in-fact may nevertheless, *if authorized*, hold such a power.
>
> Thus, the premise underpinning Kosmann's argument, that an attorney-in-fact is precluded from holding a power of appointment, is mistaken. Rather, it is merely the case that a power of attorney does not *inhere* in a power of appointment or a presently exercisable general power of appointment. Or, put differently, someone acting under a power of attorney may not, *by default*, exercise a power of appointment.
>
> ***
>
> But even if we were to adopt Kosmann's gloss on the statutes at issue and assume the position that a "general power of appointment" cannot, as a matter of statutory definition, be exercised by an attorney-in-fact, Kosmann's argument still could not prevail. Kosmann's argument that Monroe could not, as Brown's attorney-in-fact, exercise a general power of appointment runs headlong into the plain text of the Trust Agreement, which expressly contemplates such an exercise. In other words, Kosmann's argument that Monroe could not, under statute, exercise a general power of appointment is of no moment, since Brown intended, through her Trust Agreement, to prohibit her attorney-in-fact from exercising such a power, and it is Brown's intent, not the statutory definitions Kosmann references, that controls here.

23. **Seeking Information Is Not A "Contest" Under Kansas Law**. In Sutherland v. Sutherland, Trustee Norma H. Sutherland Master GST Trust, 2025 WL 1088036 (KS. App. 2025), the beneficiary of a generation skipping trust [GST], who was the grandson of deceased settlor, brought petition for declaratory judgment against settlor's son, in his capacities as trustee of the GST and as trustee of a separate revocable trust [RT] established by settlor that was supposed to fund the GST, seeking information about the RT to ensure that the GST was properly funded. Son counterclaimed, asserting that beneficiary's petition violated the GST's forfeiture provisions. The trial court agreed with the forfeiture argument, but the Court of Appeals reversed:

> The GST instrument does not provide any definition or explanation of what the term "contesting this instrument" means. Black's Law Dictionary defines "contest" as "[t]o litigate or call into question; challenge." Black's Law Dictionary 400 (12th ed. 2024). To support his position that he did not contest either the GST or the RT, Peter cites *Meyer, Executor v. Benelli*, 197 Kan. 98, 101, 415 P.2d 415 (1966) (finding a contestant seeking an interpretation of a will under which several parties claimed title to property did not constitute a will contest because the contestant "was simply seeking an interpretation of the provisions of the will under which both parties claimed title") and comment c of Restatement (Second) of Property § 9.1 ("an action commenced solely for the purpose of obtaining information concerning a donative transfer does not violate a no-contest provision"). These authorities suggest that the filing of a lawsuit does not necessarily constitute a will contest when the party filing the lawsuit merely seeks a judicial interpretation and does not challenge the provisions of the instrument itself.
>
> The district court's forfeiture ruling is premised on the implicit finding that Peter knew he was not entitled to receive the information he was seeking about the trusts at the time he filed his petition for declaratory judgment, so that the petition

> amounted to an action contesting the GST instrument. But evidence to support this finding is not clearly established in the summary judgment pleadings. Peter received a copy of the forfeiture provisions in Article 8 of the GST instrument with the letter from Hansen dated December 11, 2019. But the record is unclear when Peter first received a copy of the privacy provisions in the RT instrument. The GST trustee provided Peter with a copy of Articles 10 through 12 of the RT instrument, including Norma's expressed intention in Article 11 to keep most of the trust provisions private, during discovery. The record also shows that on November 21, 2019, Hansen mailed a letter to the beneficiaries of the RT enclosing a copy of Articles 10 through 12. This letter was sent to the GST trustee as a qualified beneficiary of the RT, but it was not mailed directly to Peter. It appears from exhibits attached to the summary judgment pleadings that at some point Peter received from his father a copy of the November 21, 2019, letter with the enclosed Articles 10 through 12. But the summary judgment pleadings do not make it clear *when* Peter received this letter and that he received it *before* he filed his petition.
>
> Regardless of the documents Peter may have possessed when he filed his petition—and even if he may have had some knowledge about the RT privacy provisions—the legal action did not contest the GST or the RT but merely sought information about the trusts and a judicial interpretation of the trust instruments. The legal action did not seek to invalidate either trust instrument; nor did it seek to remove the trustee of either trust. As a qualified beneficiary of the GST, Peter had a right to seek information about the RT, to the extent it could be provided, since the RT was the funding source for the GST. Norma passed away about a year before Peter sought a legal remedy. Up to that point, the only information Peter had received about his grandmother's estate was a letter from an attorney that explained the GST was "currently unfunded" and the amount it would be funded in the future was "unknown." Based on the record provided in the summary judgment pleadings, we disagree with the district court's legal conclusion that Peter's petition triggered the forfeiture provisions of the GST. We need not reach the district court's finding that Peter lacked probable cause to file his petition.

24. **<u>Principal and Income Act Adjustment Allowed In Massachusetts</u>**. <u>Matter of Will of Kline</u>, 244 N.E.3d 1011 (Ma. 2024), dealt with the Massachusetts Principal and Income Act, which is the 1997 Uniform Act. The testamentary trust had a beneficiary and an independent individual as co-trustees, and the individual was only an income beneficiary. The court described the background as follows:

> a. <u>Statutory framework</u>. i. <u>Competing duties</u>. Enacted in 2005, the MPIA comprehensively governs the treatment of principal and income for trusts. G. L. c. 203D, §§ 1-29. St. 2005, c. 129 (effective Jan. 1, 2006). One of the act's central purposes is to address the "vexing problem" faced by trustees saddled with the sometimes-conflicting aims of the duty to invest trust assets under the prudent investor rule, on the one hand, and the duty to administer the trust impartially so as to treat fairly both current beneficiaries entitled to distributions from net income and beneficiaries entitled to future distributions of principal, on the other. 3 M.J. Bloostein, Newhall's Settlement of Estates and Fiduciary Law in Massachusetts § 37:4.50 (5th ed. Supp. May 2024).
>
> In particular, a prudent investment strategy may counsel investing to maximize the trust's total return but may result in growth in principal without a comparable growth in income. Such a strategy may comply with the prudent investor rule, but it may improperly favor remainder beneficiaries over income beneficiaries.

Similarly, an investment strategy that maximizes traditional trust accounting income such as interest, dividends, and rents may result in a lopsided win for the income beneficiary at the expense of the remainder beneficiary. The rigid characterization of investment returns as "income" or "principal" limited a trustee's ability to take advantage of an over-all investment strategy that maximized the expected total return of the trust's assets. See *id*.

ii. Power to adjust. The MPIA solves this conundrum by permitting a trustee who pursues a prudent investment strategy to maximize the trust's total return without regard to the characterization of that return as "principal" or "income" to adjust trust assets between principal and income to administer the trust impartially based on what is fair and reasonable to all of the beneficiaries. In other words, the MPIA allows a trustee to shift what traditionally might be characterized as an increase in the value of principal to income, and vice versa, in order to maintain equitable treatment among beneficiaries while at the same time pursuing a prudent investment strategy. See Uniform Principal and Income Act § 104 comment (1997), 7A U.L.A. (Part IV) 299 (Master ed. 2017) (act "enable[s] a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of the portfolio's total return in the form of traditional trust accounting income such as interest, dividends, and rents"); Ad Hoc Principal and Income Act Committee, Massachusetts Principal and Income Act Report, in Understanding and Using Trusts, Exhibit 14A, at 20 (Mass. Cont. Legal Educ. 5th ed. 2022) (discussing power to adjust, which enables "a total return approach to investing").

Specifically, § 4 (a) of the act permits a trustee to adjust between principal and income to administer the trust impartially so as to achieve fair and reasonable treatment between beneficiaries if "the trustee considers it necessary" and if three prerequisites are met. G. L. c. 203D, § 4 (a). First, the trustee must "invest[ ] and manage[ ] trust assets as a prudent investor." Id. Second, "the terms of the trust [must] describe the amount that may or must be distributed to a beneficiary by referring to the trust's income." *Id*.

Third, the trustee must determine, "after applying the rules in [§ 3 (a)], that the trustee is unable to comply with [§ 3 (b)]." *Id*. Section 3 (a), in turn, requires compliance with the trust instrument's terms and compliance with the act, absent a "different provision" in the instrument; and § 3 (b) generally requires impartial administration of the trust so as to achieve fair and reasonable treatment of beneficiaries. G. L. c. 203D, § 3 (a), (b). Thus, the third prerequisite is met if the trust does not contain a "different provision" barring exercise of the power to adjust, and the trustee determines he or she cannot administer the trust impartially absent an adjustment between principal and income.

Importantly, the MPIA identifies the type of "different provision" required to preclude a trustee from exercising the power to adjust under the act. It provides that the

> "[t]erms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of [§ 4] unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by [§ 4 (a)]" (emphasis added).

G. L. c. 203D, § 4 (f). The Uniform Law Commission's comments to the counterpart section of the Uniform Principal and Income Act, which is identical to § 4 (f) of the MPIA, explain:

> "Since the power [to adjust] is intended to enable trustees to employ the prudent investor rule without being constrained by traditional principal and income rules, an instrument executed before the adoption of this Act whose terms describe the amount that may or must be distributed to a beneficiary by referring to the trust's income or that prohibit the invasion of principal or that prohibit equitable adjustments in general should not be construed as forbidding the use of the power to adjust under [§ 4 (a)] if the need for adjustment arises because the trustee is operating under the prudent investor rule."

> Uniform Principal and Income Act § 104(f) comment, 7A U.L.A. (Part IV) 302-303. Thus, the act authorizes a trustee to adjust trust assets between principal and income in order to administer the trust impartially, unless the trust instrument contains a "different provision" that clearly denies the trustee that power. See G. L. c. 203D, §§ 3 (a) (3), 4 (a), (f); St. 2005, c. 129, § 6.

The court held that a limitation on principal distribution did not mean that an adjustment between principal and income was precluded. Further, the court held that because there was an independent trustee the power to adjust could be exercised by the independent trustee and in fact the beneficiary trustee could ask for distribution.

25. **Providing Beneficiary With Trust Document Enabled Trustee To Avoid Liability**. In Kelley v. Savings Bank Primghar, 14 N.W.3d 771 (Ia. App. 2024), the question was whether a trustee had a duty to ensure a beneficiary understood he had a general power of appointment under the trust. The opinion states:

> Gregory Autenrieth had such a general power of appointment under the terms of a trust. But he did not exercise it in his will before he died. So Autenrieth's estate sued the trustee, Savings Bank Primghar, claiming that the bank negligently breached its fiduciary duties as trustee by failing to recognize Autenrieth did not understand his right to exercise the power of appointment in his will and advise him about it.
>
> With the agreement of the parties that the material facts were undisputed, the district court granted summary judgment to the bank. The court decided that the bank did not violate any duty owed to Autenrieth as trustee under Iowa law. And we agree that the district court did not err. Because Autenrieth was provided a copy of the trust's terms as required by the Iowa Trust Code and he never asked for any more information from the bank, it complied with all its duties under Iowa law. Even on appeal, Autenrieth's estate still has not pointed to any statute or precedent that establishes the broader duty it claims the bank breached. We thus affirm the district court's grant of summary judgment dismissing the estate's claim.

As for the trustee's duty, the court reviewed Iowa's duty to inform:

> The Trust Code imposes a range of duties on trustees. *See* Iowa Code §§ 633A.4201–.4309; *Turner v. Iowa State Bank & Tr. Co.*, 743 N.W.2d 1, 5 (Iowa 2007). But the only provision arguably implicated in advising the beneficiary of his rights under the trust is section 633A.4213, which imposes a duty to "keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and the material facts necessary to protect the beneficiaries' interests." Iowa Code § 633A.4213. It goes on in detail to impose specific requirements, including as relevant here a duty to inform a beneficiary of the "right to receive an annual accounting and a copy of the trust instrument." *Id.* §

633A.4213(1). The trustee must do so at specific triggering events, such as at "commencement of the trust administration" and when the trust becomes "irrevocable." *Id.* § 633A.4213(2)(a), (c). A violation of these duties is actionable by the beneficiary or a beneficiary's estate. *Id.* §§ 611.20, 633A.4501.

Consistent with these statutory duties, Autenrieth was provided a copy of the trust when it became irrevocable. And beyond that, at Autenrieth's first meeting with the bank, its employee informed Autenrieth he should consult an attorney to understand the trust terms and to devise a will. Autenrieth followed this advice and obtained an attorney to assist in his administrative affairs. What's more, this attorney knew of the trust's existence from Autenrieth and worked with Autenrieth to craft his will.

Before the enactment of the Trust Code, Iowa courts similarly recognized a trustee's duty to inform under the common law. *See* Martin D. Begleiter, *In the Code We Trust—Some Trust Law for Iowa at Last*, 49 Drake L. Rev. 165, 249 (2001) [hereinafter Begleiter]. But "very little case law has developed to define the scope of the duty." *Id.* A trustee must provide beneficiaries adequate information related to the trust, such as "what the trust is and how the trustee has dealt with it." *Schildberg v. Schildberg*, 461 N.W.2d 186, 191 (Iowa 1990). The duty also includes informing "beneficiaries of the existence of the trust, of their status as beneficiaries and their right to obtain further information, and of basic information concerning the trusteeship." Restatement (Third) of Trusts § 82(1)(a) (Am. L. Inst. 2007). Generally, the information a trustee must disclose to the beneficiary includes: "the existence, source, and name (or descriptive reference) of the trust; the extent and nature (present or future, discretionary or conditional, etc.) of their interests; the name(s) of the trustee(s), contact and compensation information, and perhaps the roles of co-trustees," along with the beneficiary's right to request further information. *Id.* § 82 cmt. b.

Of course, a beneficiary always has the right to request more information than initially received concerning the trust's terms. *See id.*; *see also id.* § 82 cmt. a(2) ("[A] beneficiary is always entitled ... to request such information as is reasonably necessary to enable the beneficiary to prevent or redress a breach of trust and otherwise to enforce his or her rights under the trust."). But this does not mean the trustee must explain every detail of the trust instrument and ensure the beneficiary is fully aware of each term's significance. And from this, the duty does not mean the trustee must ensure the beneficiary hews their own estate plan to maximize a non-beneficiary's interest in the trust. A trustee rarely has a duty to provide specific information without a beneficiary's request. Begleiter, 49 Drake L. Rev. at 249–50.

The bank's common-law duty was thus also fulfilled when Autenrieth received a copy of the trust document and adequate disclosures. Autenrieth was informed of the trust, his role as beneficiary, the role of the bank as trustee, and advised to seek legal advice. He did in fact seek the advice of an attorney. The information the trustee bank provided at the start gave enough information for Autenrieth (or his attorney) to either make an informed request for further information or devise his will with the proper appointing language. *See* T.P. Gallanis, *The Trustee's Duty to Inform*, 85 N.C. L. Rev. 1595, 1627 (2007) ("There must be enough information provided automatically so that the beneficiaries can make an informed request."). And neither the attorney nor Autenrieth ever asked for more information from the bank.

26. **Limitation on Alienation Void In California**. A fascinating testamentary arrangement was at issue in Godoy v. Linzner, 106 Cal.App.5th 765 (Ca. App. 2024), as summarized by the court:

> Silvia Villareal named her three children, Leticia Linzer, Arturo Villareal, and Sonia Godoy, as the beneficiaries of her living trust, the assets of which included her long-time home. Upon her death, each sibling was to receive a one-third fee simple interest in the home. In her last amendment to the trust instrument, however, Silvia decreed the siblings could only sell their respective shares for an amount well below the market value and only to each other, citing her desire to keep the home in the family. After Silvia passed, Arturo and Sonia petitioned the probate court, in part, for an order determining the trust instrument unreasonably restrained their ability to alienate their interests in the real property. Over Leticia's objection, the court granted Arturo and Sonia's requested relief and declared the amendment void.

The 2018 and 2019 trust amendments stated as follows:

> According to the 2018 restatement, the trust assets included the real property in Cerritos where Silvia resided (the Property). A provision entitled "Special Gift of the family residence," under the article governing "Distributions After [Silvia's] Death," provided that on Silvia's death, the trustee was to distribute the Property to Arturo, Sonia, and Leticia. The siblings were each to receive an undivided one-third interest, as tenants in common, of all of Silvia's interest in the Property. Silvia requested "the children retain this real property for a minimum of five years after the date of [her] death," suggesting they "could also consider selling/buying the property to/from a sibling or to one or more of [her] grandchildren." The 2018 restatement emphasized that these "requests and suggestions" were "precatory and not mandatory." The "vesting of interests" pursuant to the terms of the trust instrument was "as of the date of [Silvia's] death."
>
> The 2019 amendment stated that Silvia "would like to add the following" language to her "will/living trust": "With the intention of leaving my house to my kids (Sonia, Arturo, and Leticia) which I worked all my life for, my legacy [and] my wish, is to keep the house as a place for all three of my children to enjoy, live and prosper and not to be sold or given outside of a [*sic*] family." Below that line, she included four clauses that read in full as follows: "(A) Should any one of my children [Sonia, Arturo, or Leticia] upon my death or in the future wish to sell their portion they must to [*sic*] offer it for 100,000 (one hundred thousand doll.) to each other. [¶] (B) They must be flexible in received [*sic*] the purchase if it takes one to ten years (1-10 years). [¶] (C) If the sibling chooses to split the payments of the property 50% and 50% it is equal shares, it is my wish to do so. [¶] (D) My wish is for this home to be in the family, no outsiders. No dispute or adversary behavior among my children take place. Therefore, no contesting of my will/trust and this document. It is a gift."

So, the question was whether the 2019 restatement was unreasonable. The opinion first reviewed a vast amount of case law, from many states, opposing restraint on alienation. Then it turned to the real issue – was this restraint reasonable:

> As discussed, when a restraint on alienation encumbers a fee simple interest, the restraint is typically unreasonable because it tends "to defeat the very purpose of the interest created." (*Id.* at pp. 358-359, 6 Cal.Rptr.2d 467, 826 P.2d 710; see *Murray*, *supra*, 64 Cal. at p. 367, 28 P. 118.) Such is the case here. The trust

> instrument conveyed the Property in fee simple, which vested the siblings with the right to freely alienate their respective interests. But that right is sabotaged by the language in the 2019 amendment restricting any sale of the interests to $100,000 and only amongst the siblings.
>
> Even if those restrictions are not per se void, a weighing of the quantum of restraint and its justification counsels against their enforcement. (*Carma Developers*, *supra*, 2 Cal.4th at p. 356, 6 Cal.Rptr.2d 467, 826 P.2d 710 [" '[T]he greater the quantum of restraint that results from enforcement of a given clause, the greater must be the justification for that enforcement.' "].) Although the 2019 amendment does not completely foreclose all alienation, the probate referee's valuations of the Property—$1,050,000 at the time of Silvia's death and $1,300,000 as of December 2022—indicate the siblings stood to lose hundreds of thousands of dollars if forced to limit a sale of their one-third interests to $100,000. The quantum of restraint is even greater considering a sale could be made in a market of only two possible purchasers. While Silvia meant for these restrictions to ensure the Property stayed in the family, that justification—even if legitimate and well-intentioned—does not overcome the heavy presumption in favor of alienability. Thus, the probate court did not err in declaring the 2019 amendment void as an unreasonable restraint on alienation of the siblings' respective interests in the Property.

The court rejected the argument that the sale limitation was akin to a no contest provision because the latter are formally allowed by statute. The court also rejected the argument that the 2019 amendment in effect created a new trust.

27. <u>No Duty On An Estate Planning Attorney To Assess Competence of Testator In Illinois (maybe)</u>. In <u>Carey v. Hartz</u>, 256 N.E.3d 469 (Il. App. 2024), the facts were simple:

> Before her death, defendants Michael Hartz and Elizabeth Creasy, attorneys at defendant law firm Katten Muchin Rosenman, LLP (Katten), assisted decedent Alyce K. Newman in modifying her estate plan to benefit one of her sons. Upon discovering the modifications, Newman's other son obtained limited guardianship of her estate and person, alleging that she was suffering from dementia, and unwound the modifications. He then filed a legal malpractice action against defendants on Newman's behalf, alleging that they should have evaluated Newman's mental capacity to make changes to her estate prior to effectuating such changes.

The court held that lawyers have <u>no duty</u> to evaluate a client's mental capacity. The court relied on public policy:

> While plaintiff suggests that an affirmative duty to determine a client's competence is supported by public policy, we disagree. Plaintiff is correct that there is a public policy in favor of protecting the elderly from abuse and harm. See *County of De Witt v. American Federation of State, County & Municipal Employees, Council 31*, 298 Ill. App. 3d 634, 637, 232 Ill. Dec. 716, 699 N.E.2d 163 (1998). Similarly, there is a public policy in favor of "vigilant protection" of the disabled. See *In re Mark W.*, 228 Ill. 2d 365, 374-75, 320 Ill. Dec. 798, 888 N.E.2d 15 (2008). There is also, however, a public policy in support of testamentary freedom. See *In re Estate of Feinberg*, 235 Ill. 2d 256, 266, 335 Ill. Dec. 863, 919 N.E.2d 888 (2009). Our supreme court has long balanced these

> policies by establishing a presumption that a person is capable of exercising that testamentary freedom unless it has been established that the person is unable to do so. See, *e.g.*, *Langwisch v. Langwisch*, 361 Ill. 632, 644, 198 N.E. 675 (1935) ("The law presumes every man to be sane until the contrary is proved, and the burden of proof rests upon him who asserts the lack of testamentary capacity."); *Morecraft v. Felgenhauer*, 346 Ill. 415, 420, 178 N.E. 877 (1931) (same). Indeed, our courts have made clear that this is a lenient standard, and that a person need not be in perfect health to retain testamentary capacity. See, *e.g.*, *Anthony v. Anthony*, 20 Ill. 2d 584, 588, 170 N.E.2d 603 (1960) ("It is not necessary *** to be of absolutely sound mind in every respect in order to have sufficient mental capacity to make a will."); *In re Estate of Fordyce*, 130 Ill. App. 2d at 758, 265 N.E.2d 886 ("The fact that the decedent was aged and in feeble health does not impair the ability to properly execute a will."). We therefore cannot find that public policy requires us to impose an affirmative duty for an attorney to assess a client's competence.

In Illinois, there is a different rule if a lawyer is "on notice" of the client's disability. With respect to that issue, the opinion notes:

> In this case, the circuit court found that, even if there was a duty to assess Newman's competency, the second amended complaint failed to allege sufficient facts to demonstrate that defendants were on notice of Newman's disability. We cannot agree.
>
> The second amended complaint alleges that, at the time defendants rendered services, Newman was suffering from dementia and that signs of her impairment would be apparent upon any significant questioning. Specifically, the second amended complaint alleges that Newman was unable to accurately answer questions about her financial condition or even to answer basic questions about her life. The second amended complaint further alleges facts that suggest that the proposed modifications may have been unusually influenced by Leonard, such as the fact that the modifications were sought less than a year after the estate plan was formed, the fact that the changes all benefited Leonard, and the fact that Newman had recently made several large gifts to Leonard. At this early stage of the proceedings, we find these allegations sufficient to withstand dismissal.
>
> We recognize that, in his deposition testimony, Hartz testified that he questioned Newman and did not observe any behaviors which indicated that she lacked the capacity to understand the modifications to her estate plan. To be clear, we do not express any opinion as to whether plaintiff will ultimately prevail in proving legal malpractice, and it is possible that the evidence will establish that Hartz's conduct was entirely appropriate. A ruling on a section 2-615 motion to dismiss, however, does not weigh the evidence—it is solely concerned with whether there are allegations present which could even potentially support the cause of action alleged in the complaint. See *Vernon v. Schuster*, 179 Ill. 2d 338, 344, 228 Ill. Dec. 195, 688 N.E.2d 1172 (1997) (a motion to dismiss is reviewed *de novo* since "ruling on a motion to dismiss does not require a court to weigh facts or determine credibility"). At this point, we take all well-pleaded facts as true and interpret them in the light most favorable to plaintiff. *Young*, 213 Ill. 2d at 441, 290 Ill. Dec. 504, 821 N.E.2d 1078. Here, there are well-pleaded facts in the complaint which allege that Newman lacked the capacity to modify her estate plan at the time she engaged defendants' services and that her diminished capacity would have been apparent upon any significant questioning. Consequently, we find that plaintiff stated a cause of action for legal malpractice, and dismissal of that count of the complaint was therefore improper.

The difference between an obligation to review mental capacity and an obligation to ensure that you are not on notice is not readily clear.