May 31, 2024

Internal Revenue Service
Attn: CC:PA:01:PR (Notice 2024-28)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20224

Re: further guidance concerning basis in "grantor" trusts

To whom it may concern:

Two years ago, the Greystocke Project was among those urging the Treasury and IRS to reinstate a guidance project that had been dropped from the fiscal 2020-21 plan, and to issue formal guidance clarifying that Code section 1014 does not afford an adjustment to basis in assets held in a "grantor" trust where the value of those assets is not includible in the gross estate of the deemed owner.[1]

The project was reinstated, and in March 2023 the Treasury and IRS did issue Rev. Rul. 2023-02, 2023-1 C.B. 658, which does articulate the conclusion, but only with reference to a scenario that is expressly limited by the proviso that

> at [the settlor's] death, the liabilities of [the trust] did not exceed the [impliedly, "carryover"] basis of the assets in [the trust], and neither [the trust] nor [the settlor] held a note on which the other was the obligor.

The latter condition alone, no note outstanding, will exclude many or even most IDGTs, which are commonly used to "freeze" asset values. The former condition, liabilities not exceeding basis, seems also to implicate difficulties arising under Rev. Rul. 85-13, 1985-1 C.B. 184, about which more in a moment.

In the typical case the settlor sells to the trust an interest in a closely held business entity, often at a discount for lack of control and/or lack of marketability, and takes back a promissory note paying slightly more than the then applicable federal rate.

Any unpaid balance of the note will be included in the settlor's estate, but any appreciation in the transferred property will escape estate and generation-skipping transfer taxation. The tradeoff, assuming the 1985 revenue ruling remains in place, is that the trust and its distributees take a carryover basis. That is, of course, unless section 1014 somehow applies.

It can certainly be argued that if the transferred interest were undervalued, and/or if the interest rate or other terms of the note were

1 A copy of the Greystocke Project's 2022 submission is appended.

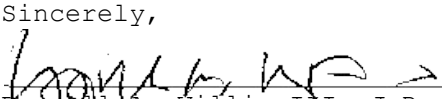
inadequate to the risks, and/or if the repayment obligation were unlikely to be satisfied except from the transferred property or its earnings,[2] we would not have "a bona fide sale for an adequate and full consideration," and the note itself should be treated as a retained interest in the underlying property under section 2036 or 2038.

But the availability of those arguments in particular cases does not justify an exception that threatens to swallow the rule. The rule here being that a taxpayer claiming a basis adjustment must file a form 8275 disclosing a reporting position inconsistent with a revenue ruling.

In any event, last year's revenue ruling is wholly inadequate, as it leaves in place the 1985 revenue ruling, which allows the "deemed owner" of a "grantor" trust to swap out high basis assets for low, thereby achieving in many cases a nearly equivalent result.[3]

The agency's nonacquiescence in *Rothstein v. United States*, 735 F.2d 704 (2d Cir. 1984), and its insistence that transactions between the settlor and the trust are to be entirely disregarded, have created an untenable situation, which could be remedied by revoking or modifying the 1985 ruling, and/or by a regulatory project under section 1015(b), treating the termination of "grantor" trust status as itself a recognition event.[4]

Sincerely,



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The Greystocke Project is a 501(c)(4) organization whose purpose is to advocate for state and federal tax and nontax legislative and regulatory measures to limit the intergenerational transferability of accumulated wealth.

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2 Cf. Rev. Rul. 77-193, 1977-1 C.B. 273.

3 See, for example, Mitchell M. Gans and Jonathan G. Blattmachr, Grantor trust assets and section 1014: new IRS ruling doesn't solve the problem, 139 Journal of Taxation 16 (Sept. 2023).

The point was also argued in a letter dated January 17, 2022 from Prof. Daniel Hemel, then of the University of Chicago School of Law, to Rep. Bill Pascrell, then chair of the Oversight subcommittee of the House Ways and Means committee, reprinted at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4024396.

4 This alternative is explored at some length in Jeffrey Pennell, Basis of grantor trust assets before the grantor's death, (Jan. 20, 2019), available at https://ssrn.com/abstract=3319242.

June 02, 2022

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2022-21)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20224

Re: section 1041 basis adjustment to assets held in IDGTs

To whom it may concern:

In Rev. Proc. 2015-37, released 06/08/15, IRS announced it would no longer provide advance determinations whether Code section 1014 affords an adjustment to basis in assets held in a "grantor" trust where those assets are not includible in the gross estate of the deemed owner.[1]

The question was assigned to section 5 of the agency's "no rule" list, areas "under study," in which rulings will not be issued pending the issuance of formal guidance. And a few weeks later, a corresponding project on "basis of grantor trust assets at death" under section 1014 was added to the priority guidance plan for fiscal 2015-16.

That project was carried in subsequent priority guidance plans for six years, but it was dropped from the plan for fiscal 2020-21, without explanation and without a formal guidance project having ever been launched.

The Greystocke Project urges the Treasury and IRS to reinstate this guidance project and to begin a process of developing formal guidance on the question, possibly under Code section 1015(b), and possibly in conjunction with a project to revoke or modify Rev. Rul. 85-13, 1985-1 C.B. 184.[2]

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1 It does not appear that any advance determinations directly addressing the issue as framed had been issued prior to the release of the revenue procedure, so this might be seen as a preemptive maneuver.

Some commenters have decried PLRs 201245006 and 201544002 as having conceded the point. The latter ruling was issued about two weeks after the effective date of revenue procedure, but expressly noted that the request had been made earlier.

While each of these letter rulings perhaps inartfully suggests that basis in assets held in a "grantor" trust would be adjusted at the deemed owner's death, in each case the reserved interests would in fact have triggered estate tax inclusion had the settlor not been a nonresident noncitizen.

2 *See*, *e.g.*, Austin Bramwell and Stephanie Vara, *Basis of grantor trust assets at death: what Treasury should do*, 160 Tax Notes 793 (Aug. 06, 2018). But also *see*, Jeffrey Pennell, *Basis of grantor trust assets before the grantor's death*, (Jan. 20, 2019), available at https://ssrn.com/abstract=3319242.

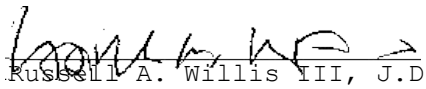
At least since the publication in September 2002 of an article in the Journal of Taxation arguing that the statute, regulations, and legislative history "do not affirmatively preclude" the result,[3] some number of tax advisors have been assisting very high net worth clients in implementing installment sales to so-called "intentionally defective" "grantor" trusts, not only to freeze asset values but also with a view toward reporting a basis adjustment in trust assets at the settlor's death, despite the fact that these assets will not be includible in the settlor's gross estate.

Although a November 2008 intra-agency e-mail message released as CCA 200937028 did express that the Chief Counsel's office "strongly disagree[d]" with a taxpayer's argument that the reservation of a section 675 "swap" power in an IDGT should alone afford a basis adjustment at the settlor's death, it does not appear that the particular case resulted in litigation, certainly not in a published court opinion.

More to the point, in the intervening dozen years Counsel's expressed view has not found its way into formal guidance. The consequence is that taxpayers adopting this reporting position are not required to disclose the fact,[4] and IRS therefore has had no effective means of identifying noncompliance or quantifying revenue losses.

This situation should not be allowed to persist.

Sincerely,



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3 Jonathan G. Blattmachr, Mitchell M. Gans, and Hugh H. Jacobson, *Income tax effects of termination of grantor trust status by reason of the grantor's death*, 97 Journal of Taxation 149 (Sept. 2002).

4 This point is articulated in greater detail in a letter dated January 17, 2022 from Prof. Daniel Hemel, then of the University of Chicago School of Law, to Rep. Bill Pascrell, chair of the Oversight subcommittee of the House Ways and Means committee, reprinted at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4024396