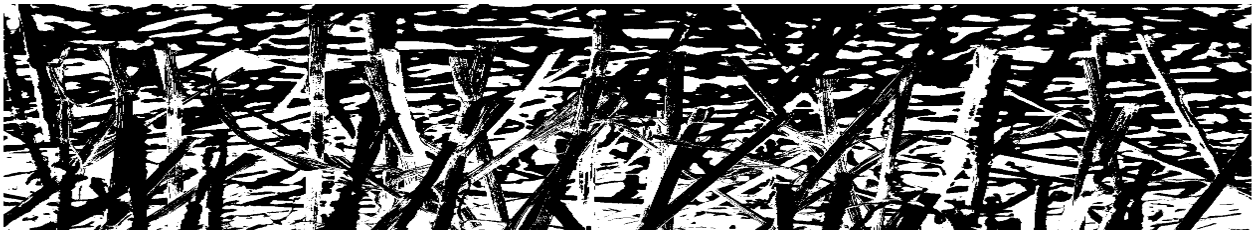

# Jack Straw Fortnightly*

## indiscipline

Where to begin.

We have proposed regs to address a potential abuse under the anti-clawback regs finalized two and a half years ago. We have proposed regs updating the life expectancy tables used to calculate the present values of income, annuity, unitrust, and remainder interests.

And we have a request for recommendations for items to be included IRS' priority guidance plan for a fiscal year ending June 30, 2023.

To which latter Jack may make a submission on behalf of the Greystocke Project, asking the agency to reinstate the project it had carried in the plan for several years but dropped this year without explanation,

to formalize the position the chief counsel's office struck in CCA 200937028, that assets held in a "grantor" trust not includible in the settlor's gross estate do not get a basis adjustment at the settlor's death.

Which should be obvious, but.

We talked about this in Jack Straw four comma seven, and again in five comma two, linking a letter Daniel J. Hemel, then of the law faculty at Chicago, now moving over to NYU, had written to Rep. Bill Pascrell, chair of the Oversight subcommittee at Ways and Means, on the subject.

As previously noted, Prof. Hemel's letter also covered a tangentially related issue, which we may also mention in our comment letter to IRS. Watch this space.

**first things first**

And we will get to the proposed regs in a minute. But before we do, your correspondent wants to indulge his penchant, his proclivity, his predilection -- these are words with a "p" this time -- for poring over recent letter rulings of a Friday morning while knocking back a cup of pourover coffee.

Specifically, PLR 202217005, released April 29.

A typical scenario in which there has been a state court proceeding to construe a pre-1985 irrevocable trust in a way that either does or does not trigger a "constructive addition," stripping the trust of its grandfathered status as exempt from the generation-skipping transfer tax.

IRS gets a dozen or two of these every year, usually in clumps involving multiple related parties and subtrusts.

The trust here benefited the settlor's son during his life, and at his death the son had a limited testamentary power to appoint outright or in further trust among descendants, with the default outright to descendants per stirpes.

The son exercised this power, appointing in further trust for his daughter, the settlor's granddaughter, giving her in turn a limited testamentary power to appoint outright or in yet further trust for more remote descendants.

There was some ambiguity in the drafting of the granddaughter's power, whether she could maybe exercise it to appoint to her own estate. Obviously not what was intended,[1] but

this could have caused inclusion in her estate, cutting short the trust's grandfathered exemption from the generation-skipping transfer tax, so the trustee petitioned the state court to construe. And the court gave a favorable ruling,

which IRS accepted as "consistent with applicable state law as it would be applied by the highest court of [the] state, per *Estate of Bosch*, 387 U.S. 456 (1967).

Therefore an exercise by the granddaughter would not be a constructive addition, therefore the trust retains its grandfathered GST exempt status.

**but wait a minute**

Somehow missing from this entire discussion is whether the son's exercise of his limited power itself created a power that could postpone vesting beyond a period ascertainable at the inception of the trust,

which per section 2041(a)(3) would be treated as a general power, taxable in son's estate, terminating GST exemption a great deal earlier. The so-called "Delaware tax trap."

Possibly state law[2] would limit the granddaughter's exercise of her limited power under a "relation back" doctrine to creating interests that would vest within periods measured from the inception of the trust.

But the text of the letter ruling does not confirm this, and Jack asks why not. Because the querent did not ask? We need clarity here.

**back claw back**

Back in November 2019, IRS finalized regs forgoing "clawback" in the estate of a decedent who dies after 2025 of gifts she might have made while the basic exclusion amount is temporarily doubled, in excess of the amount that might be in effect at the date of her death.

At the time, Jack was whingeing about how the agency had given insufficient shrift to the comment he had submitted on behalf of the Greystocke Project, challenging its statutory authority to make this concession.

But there was another comment, from the tax section of the New York State Bar, that IRS did take seriously.

You may have intended this, the comment said, or not, but the rule as proposed would provide an opportunity for abuse.

Someone might make a lifetime transfer, a completed gift, using some portion or all of the temporarily increased exclusion amount, but in a form in which the transferred property would nonetheless be included in her gross estate when she later died.

A nonqualified grantor retained income trust, for example, or an interest in a limited partnership that did not conform to the valuation requirements of section 2701.

The way you have set up the anti-clawback rule, the comment said, she would get the benefit of the temporarily increased exclusion while still retaining the economic benefit of the transferred property.[a]

And in the preamble to the final regs, IRS said, y'know, you are not wrong about this, and we do want to consider an anti-abuse rule, but we want to provide an opportunity for notice and comment, so we will reserve a slot at reg. section 20.2010-1(c)(3) and launch a separate regulatory project.

And thirty months later here we are. The proposed regs would exclude from the "special rule" of the 2019 anti-clawback regs

(a) any transfer includible in the transferor's gross estate under any of the "pullback" sections for retained interests, regardless whether some part or all of the transfer was eligible for a gift tax charitable or marital deduction,

(b) any transfer made "by enforceable promise" (think: promissory note) that remains unsatisfied at the transferor's death,

(c) any nonqualified GRIT or nonqualified entity transfer, *i.e.*, the items specifically called out in the NYSBA comments, and

(d) anything that would have fallen into one of these three categories except that the transferor (or someone) caused the tax sensitive interest to be released or destroyed within eighteen months of the transferor's death.

Jack asks, what is the authority for an eighteen month rule, which appears to be cut from whole cloth.

Also, what is the significance of the effective date, "applicable to the estates of decedents dying on or after April 27, 2022." If someone has died before the publication of this proposed reg, we are not yet concerned about clawback, which could occur only after the temporarily increased exclusion sunsets or is repealed.

Comments are due July 26.

**aging in place**

On May 05, a bit behind schedule, IRS published updated actuarial tables reflecting census data from 2010.[x]

When these proposed regs are finalized, presumably shortly after the comment period closes on July 05, the new tables will replace the existing tables, which were finalized in 2011, using data from the 2000 census. Not surprisingly, life expectancies had increased somewhat in the interval.

But taxpayers may elect to use the new tables with respect to any transaction occurring on or after January 01, 2021.

Anyone who has closed a transaction during calendar 2022 that could benefit from the new tables is in good shape. Anyone who closed a transaction during calendar 2021 whose return is still on extension likewise.

But if you wanted to use the new tables to value an annuity or unitrust interest for purposes of an income tax charitable deduction on a transaction that closed last year, and you have already filed a return claiming the deduction, you are out of luck.

In connection with that aspect of his consulting practice that involves signing off on qualified appraisals, your correspondent is busily contacting folks for whom he wrote appraisal reports using the existing tables who might benefit from the new tables.

**party like it's 2007**

Just as we were going to press, IRS released the applicable federal rates for June, and the section 7520 rate is up yet another sixty basis points to three point six. A full two hundred basis points up since February.

And while we did briefly touch this figure in November and December 2018, we seem to be heading north into territory we have not seen since before the crash in 2008.

The higher rates, combined with the increased table life expectancies mentioned above, will advantage lead trusts and gifts of "income" interests, including assignments of interests in remainder trusts.[d]

So sharpen your pencils.

## compostables

[1]

In PLR 201229005, IRS concluded, without any reference to state law, that a testamentary power in the settlor's son to appoint the remainder at his death among the settlor's descendants was "properly viewed" as not including the son himself, or his creditors or his estate, etc.

[2]

On page 5 of the letter ruling, in connection with the discussion of *Bosch*, there appears a close paraphrase of an excerpt from a decision of the relevant state court. A search for this text suggests the applicable state law here is Indiana.

That state has had one or another version of the uniform statutory rule against perpetuities in place since 1991, which does provide for relation back of a nongeneral power. And incorporates a ninety year "wait and see" rule and a mechanism for judicial reformation.

But the son's exercise may have preceded these enactments, and Jack has been unable as yet to ascertain the status of the relation back doctrine in Indiana at common law.

[3]

Not to mention a basis adjustment per section 1014(b)(9). And in fact neither the NYSBA letter nor the preamble to the newly proposed regs do mention this.

[4]

Less so gift annuities, because the deduction there is at least arguably limited to the unrecovered investment in the contract.

[5]

The last previous revision, reflecting census data from 2000, was published in 2009 as a temporary reg, with the accompanying proposed reg not finalized until 2011. So we are about three years behind here.

**Jack says, this is a dangerous place**