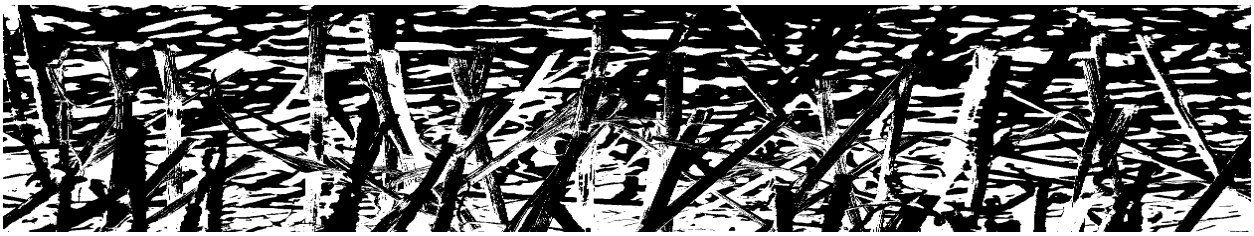

Jack Straw Fortnightly*

auguries

A week or two ago, your correspondent posted a piece titled "role playing" to the blog page of his website,

exploring an issue that has come up more than once in the course of his providing a "qualified" appraisal of the "income" and remainder interests in a split interest trust, to substantiate a claimed income and/or transfer tax charitable deduction

specifically: the need for the settlor **to release any power** she may have reserved to revoke the successive "income" interest of a spouse **before** the two of them accelerate the remainder to charity.

The article, which your correspondent also reposted to LinkedIn, goes into some detail why this step is probably necessary, but then observes that this kind of analysis is actually **not within the appraiser's limited role**,

which is not to question whether (in the particular case) the spouse's **contingent, defeasible** successive interest has any value, but simply to place a value on the transferred property **as defined by** the client's other advisors -- again, in the particular case, the two life interests combined.

It seems likely your correspondent will write a series of these articles -- "role playing two," etc. --, as the avoidable glitch described in that posting is not by any means the only scenario he has observed in which folks might have benefited from better advice earlier in the process.

Having now established a foothold in this corner of the "qualified" appraisal market, your correspondent is looking **to carve a somewhat larger niche**, offering his services not only as the person who writes the report substantiating the claimed deduction **and signs off on the 8283**,

but as an advisor who might be engaged at the inception, before any documents of transfer are signed, to guide that process as well.

through a glass darkly

There was an interesting item among the release of nonprecedential rulings a few weeks back.

Advice from the Chief Counsel's office to a program manager in estate and gift tax policy, having something

to do with the purported effect of a judicial modification of an irrevocable trust.

Nearly all of the text of PMTA 2021-05, released June 28 -- only a week after the memo was sent, quick turnaround --, is redacted. The opening sentence fragment says the memo concerns an issue that arose "during processing of the above-captioned taxpayers' [plural]" something or other, evidently one or more returns of some kind. Let's say gift, for reasons that may become apparent.

The three unredacted sentences say

(1) an order of a probate court had "extinguished the taxpayers' [again plural] power to add beneficiaries as of that date,"

(2) citation to Rev. Rul. 73-142, to the effect that such an order **does have legal effect as among the parties**, regardless whether the order is consistent with "state law properly applied,"[1] and also to Rev. Rul. 93-79, to the effect that **a retroactive modification is not binding on "third parties,"** specifically IRS, and

(3) per section 2642(f)(1), a direct skip is treated as occurring at the close of the estate tax inclusion period (ETIP) on x date, presumably the date of the probate court order.[2]

The uniform issue list codes (UILCs) reference sections 2036(a)(2), 2038(a)(2), and 2642(f)(1).

Much is hidden in the black rectangles:

- does the placement of the apostrophe indicate plural trust settlors? presumably yes, presumably a couple.

- why the reference to the 1993 revenue ruling when the probate court order at issue did not purport to have retroactive effect?

- why the UILC citation to Code sections having to do with estate tax inclusion? has one or the other settlor since died? or both? or are we talking only about the ETIP?

- and why no reference to reg. section 25.2511-2(c), when the purpose of the court order was likely to complete an incomplete gift?[3]

It would seem either

(a) we are talking about gift tax returns reporting completed gifts on entry of the probate court order, or

(b) one or both of the settlors has since died and we are talking about estate tax inclusion despite the court order.

Jack imagines the holder of a durable power seeking the court order on behalf of the disabled settlor in the last weeks of her life. But your correspondent suggests the memo is too short to implicate these issues. Also there is no UILC reference to section 2035.

But we do seem to be talking about returns plural. Possibly both settlors died within a couple years of one another, both estate tax returns are under examination simultaneously, and the E&G policy

division is asking counsel whether they could prevail on an argument that the value of the trust corpus should be included in the estate of the second to die.

Your correspondent thinks this scenario is unlikely, but in any event the citation to Rev. Rul. 73-142 suggests counsel's answer would be no. Even if the court order were somehow not consistent with state law, it was binding on the parties, and each settlor's reserved power to add beneficiaries was in fact extinguished, prospectively.

The citation to Rev. Rul. 93-79 would be by way of clarifying that the probate court order would not be binding on IRS **if it purported to be retroactive** and if we were talking about the tax treatment of some transaction that had occurred prior to the date of the court order. But it didn't and we aren't.[4]

Your correspondent thinks it is more likely we are looking at **gift tax returns** filed by each spouse **after entry of the probate court order**. This would account for the reference to the direct skip occurring at the close of the ETIP. But the reasoning would be the same.

So then what is all the redaction for? and under what circumstances would we be looking at a direct skip? Short answer to the latter question: if all of the trust beneficiaries are skip persons.

A quiet little puzzle for a Friday morning over coffee.

Query, **what was the strategy** behind reserving the power in the first instance and delaying the completion of the gift? was there perhaps a **nonskip person** in the beneficiary class who had a **shortened life expectancy**? **how many years elapsed** between the initial transfer and the probate court order? **why not simply renounce** the power? etc., etc.

Jack kinda likes the scenario with the nonskip person in the mix. Dig.

If the gift was incomplete until the date of the court order extinguishing the power, and **if a nonskip person who was a descendant** of the settlors **and a parent of the skip persons** who are now the only remaining beneficiaries **had since died**, we could have a situation in which the settlors **need not allocate GST exemption** to the transfer at all, per section 2651(e). If

if they waited to complete the gift. Jack suggests clients with this kind of money can get that kind of advice. Sometimes.

And this might have struck the folks at E&G policy as somehow wrong, explaining the necessity for the advice memo.

on the b side

In an odd bit of synchronicity, it was a letter ruling issued just a few days ago, PLR 202133006, that alerted your correspondent to the possibility of the scenario just described.

In this case, the settlor had set up a charitable remainder unitrust for the benefit of a grandchild sometime prior to the 1997 enactment of section 2651(e), which as just noted assigns a grandchild to the generation of its deceased parent.

So at the time, she would have had to allocate GST exemption to the transfer to achieve a zero inclusion ratio. But the gift tax return preparer did not make the allocation. The error was not discovered until after the settlor had died. Your typical request for 9100 relief.

Apparently, though this is not expressly stated in the text of the ruling, the transfer was also made prior to the 1986 enactment of section 2632(b)(1), which would have allocated GST exemption automatically unless the settlor had affirmatively elected out.

The ruling allows a belated allocation, effective as of the date of transfer, thirty something years ago.[5]

Jack observes that this also has the effect of rendering moot the problem of assessing a distributions tax on the unitrust payout over the intervening years.

not quite dead yet

Back in Jack Straw four comma two we discussed at some length the opinion of a Texas appeals court in *Ochse v. Ochse*, affirming a partial summary judgment to the effect that

the word "spouse," without any further descriptive, in an irrevocable trust for the benefit of the settlor's son, his spouse, and his descendants

referred only to the person to whom the son had been married for twenty odd years **at the time the trust was created**, the mother of his adult children, *i.e.*, the "first spouse," and could not be read to include the person he later married, the "second spouse," after he divorced the first.

The son and his "second spouse" have petitioned the state supreme court for review. The court pretty much had to beg the "first spouse" to file a response, which she finally did the other day.

In her response, the "first spouse" once again throws around the word "vested" as though her status as a discretionary distributee were not subject to defeasance by her former spouse's exercise of a limited power to appoint disproportionately among other beneficiaries. But this is just rhetoric, not dispositive.

The court has granted the petitioners an extension to October 01 to file a reply. Jack anticipates that the petition will then be denied,[6] and that the court will not bite on the word "vested." As the appeals court did not.

Whether the "first spouse" has any enforceable rights in the trust may or may not be determined on remand. The primary focus, as we noted in four comma two, is on the grandkids' petition to enjoin further distributions from the trust, to require an accounting, and to remove their father as trustee.

no "there" there

There has been some chatter on the listservs and twitter feeds in recent weeks on the question

whether assets held in an intentionally defective grantor trust (IDGT) might get a basis adjustment at the settlor's death,

which is after all an event that also terminates the trust's status as a disregarded entity, which may be a recognition event. Or so the reasoning goes.

Jonathan Blattmachr has been promoting this idea since at least 2002, when he made the argument briefly, in passing, in the later part of an article in the Journal of Taxation, vol. 97 page 149, co-authored by Mitchell Gans and Hugh Jacobson. [The link is to an alt.lawyers Google group.]

He may also have posted some writing on the subject to LISI, the site maintained by Stephan Leimberg, but most or all of that is behind a paywall. And I have heard him promote the idea in these webinars he is doing with Martin Shenkman.

The question has been on the IRS "no rule" list since 2015, per Rev.Proc. 2015-37. In an advice memo released in 2009, the chief counsel said they "strongly disagree[d]" with a taxpayer's argument that assets in an IDGT should get a basis adjustment at the settlor's death.

Relatedly, in Rev. Rul. 72-406, copy posted to the Jack Straw landing page, IRS has taken the position that where assets in a grantor trust revert to the settlor she still has the same basis as when she went in. Probably with reference to an ancient case out of what was then called the Board of Tax Appeals.

Ultimately, your correspondent refers the reader to Jonathan's 2002 article itself, linked above, where presumably he makes his best case. Here is the crux of the argument, quote,

> Although Section 1014(b)(9) does explicitly depend on estate-tax inclusion, Section 1014(b)(1) does not. It simply requires that the asset be acquired by bequest, devise, or inheritance (or by the decedent's estate from the decedent). To be sure, in interpreting subsection (b)(1), Reg. 1.1014-2(a)(1) appears to contemplate (as does the 1954 legislative history [FN41]) that it will apply to property passing under the decedent's will or under the laws of intestacy. Nevertheless, the Regulation, the legislative history, and the statutory language **do not affirmatively preclude** transfers made under a lifetime trust from qualifying as a bequest or devise.

end quote, emphasis supplied. Footnote 41 cites S. Rep't No. 1622, 83d Cong., 2d Sess. 4740 (1954), copy again linked to the Jack Straw landing page.

Your correspondent would not call this a full-throated endorsement of the concept.

The gist of the cited 1954 Senate report is that existing law provided for an adjustment to basis where the property was passing through a probate or probate adjacent process, revocable trusts, etc., but did not then allow an adjustment for property that was included in the decedent's gross estate for other reasons,

including specifically where it was included as "a reserved income transfer," a quick nod to the struggle that would culminate forty-two years later with the enactment of section 2702.

The IDGT is a subspecies to the "reserved income transfer," freezing the asset value in a promissory note bearing not quite as little interest as the Code will allow. But those interest payments are nonetheless income back to the settlor.

Some of the proponents are even arguing that because section 5 of the Sanders bill expressly negates such a loophole the loophole must exist. There is a rather basic logical flaw in that argument, and if that were the only argument, Jack would give it zero credit.

potpourri

item: The Oregon state supreme court has affirmed the unpublished decision of the state tax court in *Estate of Evans*, taxing a QTIP remainder in the estate of an Oregon resident on the strength of a federal election. The predeceased spouse had been a resident of Montana, which has no estate or inheritance tax. In other words, there had been no state level QTIP election.

For a fuller discussion of the issues, your correspondent refers the reader to Jack Straw three comma nine.

item: Apparently the California Franchise Tax Board was unable to find a last minute sponsor in the current session for the legislative proposal they approved last December to treat an "incomplete nongrantor trust" as a disregarded entity with respect to a California resident settlor. Maybe next session.

We discussed this briefly in Jack Straw three comma eight. The proposal is based on a similar statute enacted in 2014 in New York.

In his capacity as director of the Greystocke Project, a micro (c)(4) advocating for tax policies to combat wealth inequality, your correspondent would like to see this proposal advance in the next session. Readers who can identify likely sponsors are invited to contact him.

Also, in that capacity, your correspondent would like to see this kind of thing pursued in other states that stand to lose revenue as folks set up INGs in zero tax states.

item: An article your correspondent wrote for Bloomberg Tax Insights back in June on charitable contributions of nonfungible tokens has been holding at the extreme lower edge of the top ten for number of downloads in its micro subcategory for several weeks running.

Readers are invited to boost these numbers by downloading a copy.

item: Your correspondent will be doing a breakout session on "recent developments" on Wednesday morning, October 27 at the Minnesota planned giving conference. Virtual.

Tax and nontax, legislation, court decisions, and formal and informal guidance from IRS having at all to do with charitable gift planning.

Your correspondent will post the slide deck to the "presentations" tab on his website.

[note: readers are encouraged to suggest topics for future issues]

rough edges

[1]

In other words, counsel is saying we are not going to ignore the ostensible effect of the court order, per *Bosch v. Commissioner*, 43 T.C. 120 (1964), *aff'd* 363 F.2d 1009 (2d Cir. 1966), *rev'd* 387 U.S. 456 (1967), because it does not purport to determine the federal tax consequences of a transaction.

Readers looking to take a deeper dive into this subject may want to read *Estate of Rapp v. Commissioner*, T.C.Memo. 1996-10, *aff'd* 140 F.3d 1211 (9th Cir. 1998).

But be warned. The waters get rather murky.

[2]

Per reg. section 26.2632-1(c)(2), the ETIP is not held open for three years by section 2035.

[3]

Although section 2511 does not itself expressly deal with the question, the cited reg says a gift is incomplete

> if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

The UILC assigned to this question, albeit rarely utilized, is 2511.03.

[4]

Again with the apostrophe, and a brief nod to the late Frank Zappa.

[5]

At the time, the settlor and her spouse had elected to split the gift. The letter ruling also allows the spouse an extension to allocate GST exemption to the portion of the gift credited to her, again at date of transfer values.

[6]

In four comma two, we also discussed the opinion of a Missouri appeals court in *USBank v. Herbst*, to the effect that a trustee electing to convert an "income" trust to a unitrust need not make a threshold determination that it is otherwise unable to administer the trust impartially as between the income and remainder interests.

Jack was arguing that the election ought to be subject to judicial review for abuse of discretion.

The appellant in *Herbst* petitioned the state supreme court for review but her petition was denied. Unfortunately, the Missouri supreme court website does not offer links to these documents.

Jack says, who provideth the raven its prey?