Jack Straw Fortnightly*

ante deluvium

It has been well over a year since our last previous issue, so we can perhaps drop the asterisk, "or occasional" pretense and just go with "sporadic."

We put out exactly one issue during calendar 2023, in mid-May, and even then we omitted to discuss what arguably had been one of the more significant developments thus far that year, *id est*,

the issuance in March of Rev. Rul. 2023-02,[1] ostensibly addressing the question whether there is an adjustment at the settlor's death to the tax basis of assets held in an IDGT.

We had covered this topic in some detail three years ago in four comma seven, and we did mention in five comma eight at the end of December 2022 that the issue had been restored to the priority guidance plan for the then current fiscal year.

And the placeholder for volume six, number two, which is in fact not "forthcoming," linked three private letter rulings and a 1977 revenue ruling relevant to the discussion, see footnote 4, below. But first the revenue ruling itself.

As is typical, the ruling posits a particular scenario. The settlor has made a completed gift to a trust in which she has reserved a power that would cause income of the trust to be taxed entirely to her under subpart E of subchapter J of chapter 1, but would not trigger estate tax inclusion under chapter 11.

What is the reserved power is not specified, but presumably we are talking about an "administrative" power under section 675, as a power to control beneficial enjoyment under section 674, even if granted to a "nonadverse" third party rather than reserved by the settlor, would almost always[2] also trigger estate tax inclusion under section 2036(a)(2) and/or section 2038(a)(1) unless limited by an ascertainable standard.

swallowing the rule

But there is an oddity in the revenue ruling, the significance of which is not entirely clear to Jack.

Among the "administrative" powers enumerated in section 675 are (2) a power to borrow without adequate interest or security and (3) actual borrowing that has not been repaid at

the start of the tax year in question. There are differences of opinion on the question, but Jack is of the view that triggering "grantor" trust status through either of these mechanisms can have estate tax inclusion implications under section 2038. We can argue the details another time.

More typically, to secure "grantor" trust status for income tax purposes, the settlor will retain or grant to a "nonadverse" third party a "swap" power, exerciseable in a nonfiduciary capacity, to substitute assets of equivalent value.

The immediate point of this digression being, that the scenario proposed in Rev. Rul. 2023-02 is expressly limited by the proviso that

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

-- which latter condition, at least, excludes many or even most IDGTs, which are commonly used to "freeze" asset values, and in which the settlor might arguably have a retained interest, albeit maybe not triggering inclusion under section 2036 or 2038.[3] To flesh out this last point just slightly.

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.

Jack would argue that if the transferred interest is undervalued and/or if the interest rate on the note is inadequate, we do not have "a bona fide sale for an adequate and full consideration," and the note itself might be treated as a retained interest under 2036 or 2038.

But Jack is a voice in the wilderness. There is essentially no decisional law on this point.[4]

And of course the ruling does not even mention Rev. Rul. 85-13, which is at the root of all this. Perhaps another time. Jack says do not hold your breath. [5] Detailed discussion at five comma two.

Your correspondent wrote all this up for publication in a bimonthly publication of the St. Louis Metro bar, copy posted to SSRN and typescript linked to a blog post. So we will not go into further detail here.

words, words

On June 30 last year, a more innocent time, the Supreme Court issued its opinion in *303 Creative*, or was it *Masterpiece Cake* redux, allowing, as your correspondent put it in the abstract on SSRN for yet another article he had written for the St. Louis metro bar,[6]

> allowing a public-facing business to refuse service to someone in a protected class because of the owner's religious beliefs, but only if the service is inherently "expressive," and only if that expression can somehow be attributed to the owner herself.

The subject matter is of course a bit outside his usual scope, but your correspondent has an interest in jurisprudence, which he approaches from the perspective of what one might call critical legal theory.

And what concerned him in particular about *303 Creative* was that the state of Colorado had stipulated that the plaintiff's design services were in fact "expressive," when they very (very) obviously were not. Thereby allowing the majority to frame the issue in terms of the freedom of religious expression.

As your correspondent observed in the closing paragraph of his article, "Another party might be put to proof."

one shoe dropping

Then in November, almost a year ago now, after seventeen years of near silence on the subject, IRS dropped proposed regs that would completely upend the donor advised fund industry.

The comment period was extended thirty days, and nearly two hundred substantive comments were submitted. Most of these focused on one or both of two features of the proposed regs,

a greatly expanded definition of what even is a "donor advised fund," that would sweep in field of interest and similar funds at community foundations if "significant contributors" serve on the advisory committees, and

effectively a prohibition on paying a donor's investment advisor to manage a DAF.

We actually are not going to go into any further detail here. The "one shoe" subhead above references a webinar your correspondent put together for Bryan Clontz's firm in January. A revised version of that slide deck is included in a presentation he will be giving next week at a lunch meeting of the Chicago Council on Planned Giving.

But especially in view of the Supreme Court's recent decision in *Loper Bright*, Jack expects IRS to back off some of the positions it has taken in these proposed regs.

So it may be awhile before we get to final, or on to any of the three related projects.

oh, and

While he was neglecting this newsletter, your correspondent finally finished transcribing into book form the materials he had assembled four years ago for a series of webinars under the collective title "PG 103, stuff every charitable gift planner should kinda know."

The book, which runs 134 pages, give or take, is available for print on demand through Kindle at twenty dollars. Your correspondent does also have available for special friends a limited number of hard copies of a first printing, produced by a union shop in South Tucson.

awaiting results

Your correspondent has collected various documents in something like twenty subfolders in a folder marked "six two," which we should probably

renumber "seven two" or simply abandon.

And he has draft text discussing the Supreme Court decisions in *Moore* and *Connelly*, the denial of cert in *Quinn*, the ongoing saga in *Jarrett*.

But we are going to cut this short and watch for election results.

note finali

[1]

2023-16 I.R.B. 658 (04/17/23), dropped 03/29/23.

[2]

An exception being a limited power granted to a "nonadverse" party to add beneficiaries, see, *e.g.*, *Madorin, 84 T.C. 667 (1985)*. Typically the power is exerciseable only to add charitable distributees.

[3]

A version of this problem has been on the IRS "no rule" list for some years, see Rev. Proc. 2024-03, section 4.01(41).

But that policy, which dates back to 2013, concerns only a trust in which a third party beneficiary is treated as the "owner" under section 678.

[4]

The lore, based on a couple of letter rulings, is that estate tax inclusion may be avoided either

(a) if the trust is initially funded with assets worth at least ten pct. of the face amount of the promissory note, PLR 9535026, and/or

(b) if the trust beneficiaries credibly guarantee payment from their own independent resources, PLR 9515039.

Paren, Jack apologizes for the quality of the copies of the linked letter rulings. The alternative was to print off copies from Lexis, which include proprietary editorial content. Close paren.

The reason Jack characterizes the purported learning from these two letter rulings as "lore" is that neither ruling expressly recites the supposed principle for which it is usually cited.

What PLR 9535026 actually says is that the favorable ruling on the question whether the sale of the stock to the trust in exchange for a note paying the then current AFR depends not only on whether the stock is appropriately valued but also on assumptions

(1) that "no facts are [later] presented that would indicate that the note will not be paid according to [its] terms" and

(2) the [trust's] ability to pay the notes is not otherwise in doubt."

The ten percent threshold was simply what the lawyer requesting the ruling actually represented in the particular case, though that fact is

not even mentioned in the text of the ruling.

Similarly, what PLR 9515039 actually says is that there might have been estate tax inclusion under section 2036 where the trust settlor was to be paid a fixed annuity, nominally from earnings of the contributed "venture" --

-- but because payment of the annuity was guaranteed by the settlor's daughter, as trust remainderman, and she had more than sufficient means to meet the obligation, quote,

> the obligation is not satisfiable solely out of the underlying property and its earnings, and the size of the payments is not determined by the size of the actual income from the underlying property at the time the payments are made[,]

therefore not a retained interest, and no inclusion under section 2036. Assuming the material facts as represented remain unchanged.

The letter ruling cites Rev. Rul. 77-193 on this point, which in turn cites a 1958 opinion of the Supreme Court in a case called *Fidelity-Philadelphia Trust*, reversing a decision of the 3rd Circuit federal appeals court.

Tl;dr, if the payment obligation falls on a third party, you do not have a retained interest that can trigger estate tax inclusion.

[5]

The Greystocke Project submitted a comment last year urging the Treasury and IRS to pursue this matter further. But there is nothing in the current priority guidance plan to indicate any interest.

[6]

comma, where after all these years he still maintains a membership and is somewhat active on a couple of committees, including as relevant here the LGBTQ+ Committee, not that there is anything wrong with that.

the last hymn is sung, and the devil cries, "more"