TAX SECTION

of the Florida Bar

July 26, 2022

Internal Revenue Service
CC:PA:LPD:PR (REG-118913-21)
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments on Proposed Amendments to the Estate Tax Regulations Relating to the Basic Exclusion Amount (BEA) Applicable to the Computation of Federal Estate and Gift Taxes.

Dear Sir or Madam:

I am pleased to submit The Florida Bar Tax Section's comments to the Proposed Regulations under Section 2010 of the Internal Revenue Code (the "Code") relating to the basic exclusion amount ("BEA") applicable to the computation of Federal estate and gift taxes, specifically targeting the situation where taxpayers made certain types of gifts after 2017 and then die after the BEA is reduced.

Principal authors for these comments were Jolyon D. Acosta, Cullen I. Boggus, Mark R. Brown, Steven M. Hogan, Andrew T. Huber, David A. Lappin, Brian M. Malec, Melodie M. Menzer, William G. Smith, Alfred J. Stashis Jr., and Christopher C. Weeg.

Although the members of The Florida Bar Tax Section who participated in these comments may have clients who would be affected by the proposed regulations, no such member has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

If you or your staff would like to discuss the contents of the attached comments with the authors, please contact me at MBrown@comitersinger.com or (561) 626-2101.

Respectfully submitted,

Mark R. Brown
Chair of The Florida Bar Tax Section

FLORIDA BAR TAX SECTION

Comments on Proposed Treasury Regulations Relating to the Basic Exclusion Amount Applicable to the Computation of Federal Estate and Gift Taxes

July 26, 2022

On April 27, 2022, Treasury and the Internal Revenue Service (collectively, "Treasury") issued proposed regulations under Section 2010 of the Internal Revenue Code (the "Code") relating to the basic exclusion amount ("BEA") applicable to the computation of Federal estate and gift taxes, specifically targeting the situation where taxpayers made certain types of gifts after 2017 and then die after the BEA is reduced. Under current law, such a reduction in the BEA is scheduled to occur January 1, 2026, but it is possible that federal legislation could be enacted prior to that date which would accelerate the timing of this reduction. We thank Treasury for the opportunity to submit the comments below, which are intended to identify certain issues in, or arising from, the proposed regulations that we believe would benefit from additional clarity or consideration.

1. **The Eighteen Month Rule.**

Proposed § 20.2010-1(c)(3)(i)(D) generally provides that the special rule[1] "does not apply to transfers includible in the gross estate, or treated as includible in the gross estate for purposes of [Internal Revenue Code] section 2001(b), including . . . transfers that would have been described in paragraph (c)(3)(i)(A), (B), or (C) of this section but for the transfer, relinquishment, or elimination of an interest, power or property, effectuated *within 18 months* of the date of the decedent's death by the decedent alone, by the decedent in conjunction with any other person, or by any other person." [emphasis added]. This "18 Month Rule" appears to be targeted at eliminating the "strings" of ownership shortly before death. Proposed Treasury Regulation § 20.2010-1(c)(3)(ii) includes two exceptions to the application of the 18 month rule: (1) *de minimum* transfers – specifically transfers includible in the gross estate in which the value of the taxable portion of the transfer, determined as of the date of the transfer, was 5 percent or less than the total value of the transfer; and (2) transfers that are "effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person."

There are several aspects of the 18 Month Rule that we believe would be helpful to address further:

[1] References in these comments to the "special rule" are intended to refer to the rule adopted in final Treasury Regulation § 20.2010-1(c) published November 26, 2019, which ensures that the estate of a donor is not taxed on completed gifts that, as a result of the increased BEA, were free of gift tax when made.

A. Treasury should clarify the phrase "within 18 months".

The proposed regulations refer to transfers[2] of an interest[3] "within 18 months of the date of the decedent's death." In context, it is apparent that this refers to the transfer of an interest *prior to* the decedent's death. Though this may be apparent in context, we recommend Treasury consider revising this language to expressly refer to transfers within 18 months *prior to* the date of the decedent's death. For example, the language in Code § 1014(e)(1)(A) could serve as a model, which refers to "the 1-year period ending on the date of the decedent's death."

B. For consistency, Treasury should consider reducing the applicable period in Treasury Regulation § 20.2010-1(c)(3)(i)(D) from 18 months to 12 months.

While we applaud Treasury's intent to create a bright-line test, the preamble to the proposed regulations does not explain why the period of 18 months was selected as the applicable term. It appears the only similar references to an 18 month period are located in Treasury Regulations implementing valuation tables under Code § 7520. Specifically, Treasury Regulations §§ 20.7520-3(b)(3) and 25.7520-3(b)(3) provide that an individual is presumed to not have been terminally ill for purposes of Code § 7520 if the individual survives the relevant transfer date for a period of 18 months or longer. Both presumptions, however, can be rebutted by clear and convincing evidence.

The 18 Month Rule under the proposed regulations does not impose presumptions like the regulations under Code § 7520; rather, a bright-line cutoff is applied regardless of the taxpayer's circumstances. If a bright-line test is favored, we respectfully ask Treasury to consider whether the 18 month period should be reduced to a 12 month period to be consistent with the statutory bright-line rule enacted in Code § 1014(e) for transfers of appreciated property to a spouse prior to death. We believe that abusive transactions, which are a principal target of the proposed regulations, will still be adequately captured with a 12 month rule, and that legitimate transactions will be less likely to inadvertently be captured.

C. Treasury should clarify the meaning of "original instrument of transfer".

Proposed § 20.2010-1(c)(3)(ii)(B) generally provides that the 18 Month Rule does not apply to transfers that are "effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person." This exclusion is important in order for the special rule to continue to apply to legitimate transactions sanctioned in the Code, like GRATs and QPRTs, that have completed their terms within 18 months prior to a decedent's death. We believe it would be helpful to clarify whether this exception would apply in the context of an enforceable promise that, pursuant to requirements contained in the documentation evidencing the promise (such as a requirement for the promised

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[2] For the sake of brevity, the term "transfer" is used in these comments to refer to the phrase "transfer, relinquishment, or elimination" in the proposed regulations.

[3] For the sake of brevity, the term "interest" in these comments to refer to the phrase "interest, power, or property" in the proposed regulations.

amount to be paid off by a specified date or upon the death of someone other than the donor), is actually paid off within 18 months prior to the donor's death. Furthermore, asset transfers are often accomplished by a package of interrelated documents (including deeds, assignment instruments, trust instruments, etc.). We believe it would be helpful for Treasury to clarify what type of documentation may fit within the scope of an "original instrument of transfer." Perhaps the phrase "in the original instrument of transfer *and other related documents*" may be more appropriate. Lastly, we believe it would also be helpful to clarify whether the reference to "any person" includes the donor.

D. Treasury should clarify whether the 18 Month Rule applies to the bona fide sale of an interest.

Code § 2036(a) does not apply to transfers that are "a bona fide sale for an adequate and full consideration in money or money's worth" regardless of how close in time to the decedent's death such sale is made. The references to the "transfer, relinquishment, or elimination of an interest, power or property . . . by the decedent alone, by the decedent in conjunction with any other person, or by any other person" in proposed § 20.2010-1(c)(3)(i) arguably could be construed to apply to a bona fide sale of a taxpayer's interest within the 18 month period prior to the taxpayer's death, although general estate tax principals suggest it should not be since such a sale is excluded from Code § 2036(a). Therefore, we request Treasury clarify the interrelationship between the bona fide sale concept and the 18 Month Rule, and specifically whether a bona fide sale of an interest by the taxpayer could be captured by the 18 Month Rule.

E. Treasury should clarify how the exception to the special rule would apply to an asset which is partially transferred before the 18 month period and partially transferred within the 18 month period.

We respectfully request Treasury provide an additional example to illustrate the consequences of transactions or transfers which may be partially completed more than 18 months prior to the taxpayer's death, and partially completed within 18 months of the taxpayer's death. The purpose of including such an example is to illustrate the differences, if any, between a transfer described in proposed § 20.2010-1(c)(3)(i)(D) compared to the exception in proposed § 20.2010-1(c)(3)(ii)(B) for transfers "as a result of the passage of time." For example, assume a taxpayer makes a gift of an enforceable promise, a portion of which is paid off more than 18 months prior to the taxpayer's death, a portion of which is paid within 18 months prior to the taxpayer's death, and a portion of which remains unpaid at death. Further, assume the portion paid within 18 months prior to the taxpayer's death was paid in the form of fixed monthly payments in compliance with the stated payment terms of the enforceable promise. We believe an example such as this would help readers understand how the rules set forth in the proposed regulations are intended to be implemented, including how the taxpayer's BEA would be applied in the calculation of adjusted taxable gifts and gift tax payable.

F. Treasury should clarify the application of the 18 Month Rule to Code § 2701 interests.

We respectfully request Treasury provide additional guidance, perhaps in the form of examples, to illustrate the application of the proposed regulations to transfers described in §

25.2701-5(a)(4) and § 25.2702-6(a)(1) that are intended to be included in the decedent's gross estate. Such transfers may take the form of preferred partnership interests, rights to guaranteed payments of a fixed amount under Section 707(c), rights to management fees or other fees for bona fide services, and proportionate transfers of equity interests described in § 25.2701- 1(c)(4). Capturing the anti-abuse intent in this area could prove challenging, and thus, provision of and reliance on bright-line rules with respect to equity interest transfers would be beneficial to provide clarity to taxpayers.

2. Treasury should clarify the application of the 18 month rule to Qualified Personal Residence Trusts.

The Qualified Personal Residence Trust ("QPRT") is a commonly used estate planning tool sanctioned by Code § 2702. A QPRT works similar to a GRAT: the grantor contributes property (in the case of a QPRT, a personal residence) to a trust whose terms permit the grantor continued use of the property for a specified term. The grantor is not treated as making a gift of the retained interest, but is treated as making a taxable gift equal to the value of the remainder interest. If the grantor dies prior to the end of the term, the retained interest triggers estate tax inclusion for the value of the QPRT under Code § 2036.

Proposed § 20.2010-1(c)(3)(A) seems to make clear that the exception to the special rule would operate to include the value of QPRT property in the grantor's gross estate if the grantor died during the QPRT term, since the retained right to use the QPRT property would constitute a transfer includible in the gross estate pursuant to section 2036. This is supported by Example 4's reliance on § 20.2036-1(c)(2) to include the GRAT property in the decedent's gross estate. Treasury Regulations § 20.2036-1(c)(2) also, by its flush language, applies to QPRTs.

While the proposed regulations provide sufficient language to determine their application in the context of a QPRT, given the frequency of QPRT usage, we believe practitioners would welcome a specific example from Treasury to add certainty. We offer the following example for Treasury to consider:

> **Example:** Individual A transfers a personal residence worth $7 million to a Qualified Personal Residence Trust within the meaning of §25.2702-5(c) whose terms provide that Individual A may continue to use the home for a certain term of years. The taxable portion of the transfer is $2.7 million. A died during the term of the QPRT. The entire QPRT corpus is includible in the gross estate pursuant to §20.2036-1(c)(2). Because the value of the taxable portion of the transfer was more than 5 percent of the total value of the transfer determined as of the date of the gift, the 5 percent de minimis rule in paragraph (c)(3)(ii)(A) of this section is not met and the exception to the special rule found in paragraph (c)(3) of this section applies to the gift. The credit to be applied for purposes of computing A's estate tax is based on the $6.8 million basic exclusion amount as of A's date of death, subject to the limitation of section 2010(d).

In the alternative, language could be added to Example 4 or Example 5 to clarify the application outside of the GRAT context. An example of such additional language (in *italics*) follows:

> **Example 5:** Assume that the facts are the same as in paragraph (c)(3)(iii)(D) of this section (Example 4) except that B's qualified annuity interest is valued at $8 million. The taxable portion of the transfer valued as of the date of the transfer was $1 million. Because the value of the taxable portion of the transfer was more than 5 percent of the total value of the transfer determined as of the date of the gift, the 5 percent de minimis rule in paragraph (c)(3)(ii)(A) of this section is not met and the exception to the special rule found in paragraph (c)(3) of this section applies to the gift. The credit to be applied for purposes of computing B's estate tax is based on the $6.8 million basic exclusion amount as of B's date of death, subject to the limitation of section 2010(d). *The same results would occur if the annuity interest of this Example 5 and the preceding Example 4 were instead replaced with a retained right to use a residence contributed to a qualified personal residence trust, or any other retained or reserved interest as those terms are described in §20.2036-1(c).*

3. Treasury should issue additional guidance with respect to the application of proposed § 20.2010-1(c)(3)(B) in the context of a gift of an entity interest where the donor owes a bona fide note obligation to the entity.

It is unclear how the proposed regulations would apply in a situation where a donor transfers an interest in an entity that has extended a loan to the donor, which is common in closely-held entities. Where a donor makes a gift of the donor's interest in the entity to which the loan obligation is due, the entity's right to repayment is factored in as part of the valuation of the entity interest. Assuming the gift of an entity interest is structured in a manner that will not be includible in the donor's gross estate under Code §§ 2035, 2036, 2037, 2038 or 2042, it is unclear under the proposed regulations whether the donor's bona fide repayment obligation to the entity could be captured by the rules under paragraphs (c)(3)(i)(B) and (c)(3)(i)(D) relating to the transfer of an enforceable promise.

Clearly, there are situations where the transfer of an interest in an entity that has extended a loan to a donor could be abusive. However, in most situations, the debt is bona fide and not designed to artificially consume an individual's BEA before assets are actually transferred. The law is clear on factors that can be examined to determine whether such a loan is bona fide, including, but not limited to, whether consideration was given in exchange for the loan, whether appropriate interest is charged, whether the debtor timely pays interest and principal, whether security is issued in connection with the loan, and whether the loan is memorialized in writing.

We respectfully request that additional guidance be issued to clarify that bona fide loans outstanding at the obligor's death to an entity in which the donor has previously gifted an interest are not subject to the exceptions to the special rule. From a policy standpoint, such loans should

not be treated the same as the transfer of an enforceable promise because they are not abusive transactions.

4. Treasury should address policy concerns with the application of the proposed regulations to gifts structured in compliance with Chapter 14.

We ask that consideration be given to whether the proposed regulations, which appear at least in part to have been targeted to prevent abusive transactions, should not apply to a gift properly structured in accordance with the safe harbor rules of Chapter 14, including a GRAT or QPRT, at least not where the retained term was scheduled to expire within the taxpayer's remaining life expectancy.

Chapter 14 causes all retained interests, other than certain retained annuity interests and retained unitrust interests (such as GRATs or QPRTs), to be valued at zero. Congress has, by statute, under Chapter 14 created specific exceptions for GRATs and QPRTs for which the value of the retained interest and taxable gift are determined differently. Specifically, the value of the taxable gift is determined actuarially and accounts for the taxpayer's right to use the residence for the trust term (as to a QPRT), the taxpayer's annuity right (as to a GRAT), and the right of reversion (as to both the QPRT and GRAT), should the taxpayer die during the retained term. Additionally, a taxpayer who creates a GRAT or QPRT and dies within the retained term is required to include the value of the property, and exclude the prior gift, in determining the value of his or her gross estate.

In establishing such safe harbors, Congress has recognized the substance of gifts established under GRAT and QPRT structures as bona fide inter vivos gifts. Such structures are not abusive in that they are specifically authorized by statute. Accordingly, they arguably should not be treated the same as abusive transactions targeted by the proposed regulations, particularly where the retained term is within the taxpayer's remaining life expectancy. In that context, it seems appropriate that a taxpayer should benefit from the increased BEA available as of the date of the original gift.

5. Treasury should clarify the application of the exceptions to the special rule in the context of GST tax.

Proposed § 20.2010-1(c)(3)(i)(B) and (C) effectively operate to claw back prior gifts into the calculation of estate tax even though such prior gifts are not includible in the decedent's gross estate under Code §§ 2035, 2036, 2037, 2038 or 2042. It is unclear whether this treatment will impact (1) the allocation of GST exemption made by the taxpayer at the time of the gift during the increased BEA period or (2) the GST tax calculated for a decedent's estate where the application of the proposed regulations results in an increase in the decedent's estate tax. Admittedly, applying the GST tax rules in the framework of the proposed regulations is complex and difficult. Therefore, we respectfully ask Treasury to consider adding an additional example or commentary in the preamble to provide guidance on the effect of the exceptions to the special rule for GST tax purposes.

6. <u>Treasury should clarify the policy for the disparate treatment of the satisfactions of an enforceable promise versus outright gifts of cash or other property.</u>

Historically, taxpayers have been able to rely on the holding of Revenue Ruling 84-25, 1984-1 C.B. 191, that the gratuitous transfer of a legally binding promissory note is a completed gift under Code § 2511. Per Revenue Ruling 84-25, to the extent that the note had been paid prior to the decedent's death, the assets used to satisfy the note would not be included in the decedent's estate, and therefore the satisfied note (or the satisfied portion thereof) would be included in the decedent's adjusted taxable gifts. This treatment is consistent with the treatment of a taxpayer's lifetime gift of cash or other assets. In either situation, if a transfer not otherwise subject to the tail provisions of Code § 2035 is completed prior to death, the value of the gift would be included in the decedent's adjusted taxable gifts. Because proposed § 20.2010-1(c)(3)(i)(B) departs from these traditional principles, we respectfully ask Treasury clarify (and perhaps include an example) the rationale for the disparate treatment between outright cash gifts and gifts by enforceable promise which are satisfied within 18 months of the grantor's death.

Guidance to cure this disparity is needed for common planning situations. Consider, for instance, that under Revenue Ruling 84-25 and the rules set forth in (final) § 20.2010-1, a taxpayer may wish to make a gift using a legally binding promissory note at a time when the taxpayer does not have liquid or freely transferable assets to give, but expects to have the liquidity in the future to make the payments required under the promissory note.

7. <u>Treasury should give additional consideration to the effective date of the proposed regulations.</u>

Proposed § 20.2010-1(f)(2) provides that Paragraph (c)(3) (which includes the 18 Month Rule) is applicable to the estates of decedents dying on or after April 27, 2022. This effective date can lead to unfairness insofar as it already may be "too late" for a taxpayer to escape the application of the 18 Month Rule. For example, in the case of a gift of an enforceable promise made prior to the publication of the proposed regulations, the taxpayer could today pay in full the previously-transferred promissory note, and then die within 18 months at a time when the basic exclusion amount has been reduced by federal legislation enacted in the interim. We respectfully submit that the effective date of the 18 Month Rule should be, at a minimum, applicable only to the estates of decedents dying on or after the date final regulations are issued, or on or after the date which is 18 months after final regulations are issued. Such an effective date would provide taxpayers who had previously relied on Revenue Ruling 84-25 and § 20.2010-1 with an opportunity to reorient their affairs, for example, by paying in full any previously transferred enforceable promise to adjust for the impact of this new 18 Month Rule.