

WASHINGTON WATCH

CHECKING IN WITH THE GUIDANCE DEPARTMENT

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While the rest of us have been distracted by the presidential election, the estate and gift attorneys at the IRS have been steadily issuing guidance and setting forth an ambitious plan for more. The 2008-2009 Priority Guidance Plan,¹ dated 9/10/08, lists 15 projects under the heading of "Gifts and Estates and Trusts," plus one additional procedural project that is estate tax-related. We can look forward to receiving guidance on these issues in the 2008-2009 year:

Priority Guidance Plan projects

Regulations under Section 67 regarding miscellaneous itemized deductions of a trust or estate. The IRS issued Proposed Regulations on this subject on 7/27/07,² in an effort to provide consistency in an area where several U.S. Courts of Appeal were in disagreement. The Proposed Regulations took the position

that in order for a miscellaneous expense incurred by a trust or estate not to be subject to the 2% floor, the expense must be unique to an estate or trust. In other words, the expense would be subject to the 2% floor unless "an individual could not have incurred that cost in connection with property not held in an estate or trust."

The Proposed Regulations also provided that the taxpayer must use a "reasonable method" to unbundle any bundled fees. After the Proposed Regulations were issued, the Supreme Court, on 1/16/08, issued its decision in *Knight*,³ resolving the conflict among the circuits. Although the Supreme Court ruled in favor of the Commissioner, it articulated a test different from that in the Proposed Regulations. The Supreme Court ruled that the test is whether the particular expenses are "customarily" incurred by individuals holding assets outside of a trust or estate.

The IRS has not withdrawn or re-proposed the Regulations. Instead, the Priority Guidance Plan implies that the IRS will next issue final Regulations. It is possible that the IRS could adopt the Supreme Court's test without re-proposing the Regulations. In fact, the more interesting part of this project might be the IRS's conclusions on unbundling of investment advisory fees, a provision that received a lot of comments after the Proposed Regulations were issued.

Guidance under Section 529 regarding qualified tuition programs. In Announcement 2008-17,⁴ the IRS invited public comment on issues to be addressed in forthcoming Regulations on Section 529 plans.

These Proposed Regulations will be issued under the authority granted in Section 529(f), added to the Code under the Pension Protection Act of 2006.⁵ That provision states that notwithstanding any other provision of Section 529, the Secretary shall prescribe Regulations "necessary or appropriate to carry out the purposes" of Section 529 and "to prevent abuse . . . including regulations under chapters 11, 12 and 13."

The legislative history of Section 529(f) discusses two abuses that concerned the Congress. First, Congress was worried that a taxpayer would set up multiple 529 plans with different designated beneficiaries, in each case taking advantage of the ability to use five years' worth of annual exclusions up front. Later, the taxpayer would change the designated beneficiary so as to have effectively claimed more than one annual exclusion with respect to that beneficiary. The second abuse about which Congress was concerned was the ability of a taxpayer to use a 529 plan account for retirement savings.⁶ To these, the IRS added its own concerns outlined in the Announcement: a contributor putting funds in a 529 plan account for himself and then changing the designated beneficiary and avoiding the gift tax, and general concerns stemming from the fact that contributions to 529 plan accounts are treated as completed gifts even though the account owner has the right to withdraw funds.

The IRS asked for comments on a general anti-abuse Regulation, as well as specific contemplated provisions related to the perceived abuses of 529 plans. This technique of outlining the substance of Proposed

¹ See www.irs.gov/pub/irs-il/2008-2009pgp.pdf.

² REG-128224-06, 72 Fed. Reg. 41,243 (7/27/07).

³ 128 S.Ct. 782, 101 AFTR2d 2008-544 (2008).

⁴ 2008-9 IRB 512.

⁵ Pub. L. No. 109-280 (8/17/06).

⁶ See Joint Committee on Taxation, Technical Explanation of H.R. 4, the "Pension Protec-

tion Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006 (JCX-38-06) at 369.

Regulations and requesting comments is fairly unusual, although not unheard of. In this case, it reflects the confusion in the area and a frustration with the numerous attempts by both Congress and the IRS since Section 529 was enacted to try to get it right. We can expect that the guidance to be issued will come in the form of Proposed Regulations.

Final Regulations under Section 642(c) concerning the ordering rules for charitable payments made by a charitable lead trust. On 6/18/08, the IRS issued Proposed Regulations applicable to charitable lead trusts minimizing the opportunities to deviate from allocating to a charitable beneficiary the same proportion of each class of income as the total of each class bears to the total of all income.⁷ Prior to the Proposed Regulations, the proportional presumption could be overcome either by a provision in applicable local law or by a provision in the governing instrument.

The Proposed Regulations require that, in order to be respected, a deviation from a proportional allocation must have real economic substance. Thus, if the Proposed Regulations are made final, a taxpayer would not be able to allocate ordinary income first to charity so as to minimize the tax of noncharitable beneficiaries. However, if the amount of a charity's distribution was actually determined by the amount of ordinary income received by the trust, that would have real economic substance. The Priority Guidance Plan includes finalization of these Regulations.

Guidance under Section 643 regarding uniform basis rules for trusts. This project is new to the Priority Guidance Plan. It presumably will speak to the application of

the uniform basis rules of Section 1014 to distributions of property in kind under Section 643(e) from a trust to a beneficiary.

Adjustments to sample charitable trust forms under Section 664. Over the past several years, the IRS has been releasing very helpful sample trust documents for charitable remainder trusts. This new project will offer revisions to some of those sample documents. This is another new project on the Plan.

Revenue Ruling regarding the consequences under various income, estate, gift, and generation-skipping transfer tax provisions of using a family owned company as a trustee of a trust. The IRS has issued a series of private letter rulings on the consequences of using a family owned trust company as trustee. On 7/11/08, the IRS issued Notice 2008-63 with the text of a proposed Revenue Ruling.⁸ The proposed Revenue Ruling essentially gives two safe harbors. The first situation involves a private trust company created under the laws of a state that has enacted a private trust company statute. The second situation involves a private trust company formed in a state that does not have such a statute. In both cases, the proposed Revenue Ruling specifies a set of conditions under which the use of a private trust company as trustee will not cause the trust to be treated as a grantor trust, will not cause the grantor to have made an incomplete gift to the trust, will not cause the assets of the trust to be included in the grantor's estate, and will not cause a trust exempt from the generation-skipping transfer tax to become non-exempt.

The requirements set forth in the proposed Revenue Ruling are somewhat more restrictive than some of

the situations in which private letter rulings have been granted. The IRS requested comments on the proposed Revenue Ruling, and the Priority Guidance Plan anticipates that the final Revenue Ruling will be released in the 2008-2009 year. By seeking public comment on a proposed Revenue Ruling, the IRS is once again following an atypical procedure, but one that allows increased input from the public.

Final Regulations under Section 2032(a) regarding imposition of restrictions on estate assets during the six-month valuation period. The IRS issued Proposed Regulations under Section 2032(a), dealing with the alternate valuation date, on 4/25/08.⁹ The Regulations, issued in response to the Tax Court decision in *Kohler*,¹⁰ limit the ways in which the value of the estate can be reduced during the six-month period after death to enable the estate to qualify for use of the alternate valuation date.

In the *Kohler* case, two months after the decedent died, the Kohler company completed a reorganization that had been under consideration for some time. The new stock was subject to more restrictions on transferability than was the surrendered stock. The Tax Court found that the estate qualified to use the alternate valuation date.

The Proposed Regulations limit the availability of the alternate valuation date to estates that qualify due to a change in "market conditions." The term "market conditions" is defined as "events outside the control of the decedent (or the decedent's executor or trustee) or other person whose property is being valued that affect the fair market value of the property being valued." The Priority

⁷ REG-101258-08, 73 Fed. Reg. 34,670 (6/18/08).

⁸ 2008-31 IRB 261.

⁹ REG-112196-07, 73 Fed. Reg. 22,300 (4/25/08).

¹⁰ TCM 2006-152, *nonacq.* AOD 2008-01 (3/3/08), and IRB 2008-9.

Guidance Plan anticipates the finalization of these Regulations.

Guidance under Section 2036 regarding graduated grantor retained annuity trusts ('GRATs'). Under Reg. 25.2702-3(b)(1)(ii), GRAT annuity payments are permitted to increase by no more than 20% over the previous year's payment. A GRAT with such an increasing payment is known as a graduated GRAT. New to the Priority Guidance Plan this year, this project promises guidance on the inclusion of graduated GRATs in the grantor's estate.

This issue was left unresolved when new Reg. 20.2036-1(c) was finalized in July 2008.¹¹ The Preamble to those Regulations noted: "A commentator requested that examples be provided that address a GRAT from which the grantor receives increasing annuity payments. The commentator suggested two alternative methods for valuing the annuity and requested that the IRS provide guidance on the appropriate method. The IRS and Treasury Department agree that such an example would be helpful and appropriate but believe the issue requires further consideration."¹² The IRS reserved Reg. 20.2036-1(c)(2)(ii) for a section on "graduated retained interests." We can probably expect an additional example as well.

Three projects under Section 2053. The Priority Guidance Plan lists three projects under Section 2053. Two of the projects appear to be spin-offs from the third. On 4/23/07, the IRS issued Proposed Regulations under Section 2053 regarding the extent to which post-death events may be considered in determining the deductible amount of a claim against the estate.¹³

These Proposed Regulations provide guidance in an area in which the case law has been in conflict. In general, the Proposed Regulations allow post-death events to be taken into account in valuing claims. Where the validity of the claim has not been resolved before the statute of limitations closes on the estate tax return, the Proposed Regulations direct that a protective refund claim should be filed.

The provisions of the Proposed Regulations give rise to additional unresolved questions, however. Consequently, the Priority Guidance Plan also lists two new projects under Section 2053. First, guidance will be issued on the procedures for filing and perfecting protective refund claims for amounts deductible under Section 2053. This guidance will be necessary if the Proposed Section 2053 Regulations are finalized, as they introduce the need for a protective claim in some circumstances. Second, guidance will be provided under Section 2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of the administration expenses and claims against the estate. This project also appears to be an outgrowth of issues raised regarding the Proposed Section 2053 Regulations.

Final Regulations under Section 2642(g) regarding extensions of time to make allocations of the generation-skipping transfer tax exemption. On 4/17/08, the IRS issued Proposed Regulations providing specific requirements that must be satisfied when relief is sought to make a late retroactive allocation of generation-skipping transfer tax exemption.¹⁴ These Regulations are re-

quired by Section 2642(g)(1)(A), which was added to the Code in 2001. Since 2001, taxpayers have been applying for relief under the Section 9100 Regulations¹⁵ pursuant to Notice 2001-50.¹⁶ The Proposed Regulations are far more detailed and demanding than the 9100 Regulations. The Priority Guidance Plan includes finalization of these Regulations.

Guidance under Section 2704 regarding restrictions on the liquidation of an interest in a corporation or partnership. This project is making its sixth annual appearance on the Priority Guidance Plan. It is presumably intended to exercise the regulatory authority granted in Section 2704(b)(4) of the Code. However, these issues either must be proving difficult, or they are not a high priority for the IRS.

Final Regulations under Section 7477 regarding declaratory judgment procedures relating to gift tax valuation issues. On 6/6/08, the IRS issued Proposed Regulations on the procedures for obtaining a declaratory judgment on gift tax valuation issues.¹⁷ This project stems from a 1997 change in law. These Regulations are slated to be finalized this year.

Guidance under Section 7520 updating the mortality based actuarial tables to reflect data compiled from the 2000 census. This project is a required decennial update to the mortality tables. Under Section 7520(c)(3), the original mortality tables were to be issued by 12/31/89, with required revisions every ten years. By statute, then, this project will have to be completed by 12/31/09.

Regulations regarding the furnishing of security in connection with

¹¹ TD 9414, 73 Fed. Reg. 40,173 (7/14/08).

¹² *Id.* at 40,176.

¹³ REG-143316-03, 72 Fed. Reg. 20,080 (4/23/07).

¹⁴ REG-147775-06, 73 Fed. Reg. 20,870 (4/17/08).

¹⁵ Reg. 301.9100-3.

¹⁶ 2001-2 CB 189.

¹⁷ REG-143716-04, 73 Fed. Reg. 32,503 (6/9/08).

an election to pay the estate tax in installments under Section 6166. In *Estate of Roski*,¹⁸ the Tax Court found that the IRS had abused its discretion in requiring all estates electing to defer estate tax under Section 6166 to post a bond or accept a special lien. In response to that decision, the IRS issued interim guidance on the issue in Notice 2007-90.¹⁹ The Notice announces that the IRS will now determine whether security is needed on a case-by-case basis. The IRS proposes to take into account the dura-

tion and stability of the business, the ability to pay the installments of tax and interest on a timely basis, and the business's tax compliance history. The Notice requests comments on the standards that the IRS should apply in determining whether security should be required. The IRS plans to issue Proposed Regulations on this issue.

Conclusion

The IRS has set forth an ambitious plan for guidance in the com-

ing year. The sheer number of projects to be finalized this year makes it clear how productive the IRS has been in issuing proposed guidance in the past year or so. While it is most unlikely that all of these projects will be completed by 6/30/09, we can certainly expect to see many of them issued in the coming months.

¹⁸ 128 TC 113 (2007).

¹⁹ 2007-46 IRB 1003.