Comments of the American College of Trust and Estate Counsel ("ACTEC") on Proposed Regulations under Code Section 2010 Concerning Limitation on the Special Rule Regarding a Difference in the Basic Exclusion Amount

Treasury Notice 87 Fed. Reg. 24918 (4/27/22) requested comments on proposed regulations ("Proposed Regulations") issued under Code[1] section 2010 that would modify final Regulations published by the Treasury Department and IRS on November 26, 2019 (T.D. 9884) ("Final Regulations"). Specifically, the Final Regulations created a taxpayer favorable "Special Rule" to be applied in situations described in Section 2001(g)(2), where the basic exclusion amount described in Section 2010(c)(3) (the "BEA") in effect at the time of a decedent's death is lower than the BEA applicable to gifts made during the decedent's lifetime in order to prevent a clawback of the BEA at death. The Proposed Regulations would limit the application of the Special Rule in certain situations described therein (hereinafter, referred to respectively as "Boomerang Clawback Regulations" and the "Boomerang Clawback").

BACKGROUND

Section 2010(c)(3)

Section 11061 of the Tax Cuts and Jobs Act of 2017 ("Act") amended Section 2010(c)(3) to provide that for decedents dying and gifts made during the period from January 1, 2018, through December 31, 2025, the BEA is increased from $5 million to $10 million, as adjusted for inflation ("increased BEA"). Under the Act, the increased BEA will revert to $5 million as adjusted for inflation on January 1, 2026.

Section 2001(g)(2)

The Act also added new Section 2001(g)(2), which grants the Secretary of the Treasury the authority to enact regulations necessary or appropriate to carry out Section 2001 with respect to any difference between the BEA applicable at a decedent's death and the BEA applicable in the year in which the decedent made any gifts during his or her life.

The Final Regulations

The Final Regulations adopted the Special Rule that applies in cases where the credit against the estate tax that is attributable to the BEA is less at the date of death than the sum of the credits attributable to the BEA allowable in computing gift tax payable within the meaning of Section 2001(b)(2) with regard to the decedent's lifetime gifts. In these cases, the portion of the credit against the net tentative estate tax that is attributable to the BEA is based on the sum of the credits attributable to the BEA allowable in computing gift tax payable regarding the decedent's lifetime gifts.

[1] Unless otherwise stated, references herein to "Section(s)" or to "Code" are to the Internal Revenue Code of 1986, as amended. References herein to "§" are to relevant sections of the Code or the Treasury regulations promulgated thereunder.

The Preamble to the Final Regulations stated, "The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes." That Preamble went on to reason that if a transfer is includible in the gross estate, the possibility for such inconsistency does not arise; therefore, an anti-abuse provision could be adopted that excepts transfers includible in the gross estate from the application of the Special Rule.

The Preamble then stated as follows:

> "A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. ***An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death.*** Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment." (***Emphasis*** added)

The Final Regulations reserved § 20.2010-1(c)(3), and this issue is the subject of the Boomerang Clawback Regulations.[2]

DISCUSSION

1. General Policy Concerns

Both the Preamble to the Final Regulations and the Preamble to the Boomerang Clawback Regulations contain several references to the types of transactions that the Boomerang Clawback Regulations intend to exclude from the Special Rule. As cited above, the Preamble to the Final Regulations stated that further consideration would be given to the issue of whether gifts that are not "true inter vivos transfers" should be excepted from the Special Rule. Similarly, the Preamble to the Boomerang Clawback Regulations distinguishes between "completed gifts that are treated as adjusted taxable gifts," and "completed gifts that are treated as testamentary transfers," and it also refers to a "bona fide" inter vivos gift versus a gift of property that is includible in the Grantor's gross estate.

Further, Prop. Treas. Reg. § 20.2010-1(c)(3)(i) states that, except as provided in Prop. Treas. Reg. § 20.2010-1(c)(3)(ii), the Special Rule does not apply to transfers includible in the

[2] The proposed regulations can be found at the following link: https://www.govinfo.gov/content/pkg/FR-2022-04-27/pdf/2022-08865.pdf

gross estate, or treated as includible in the gross estate for purposes of § 2001(b), including "without limitation" four specific categories of transfers:

- Transfers includible in the gross estate pursuant to §§ 2035, 2036, 2037, 2038 or 2042, regardless of whether any part of the transfer was deductible pursuant to §§ 2522 or 2523;
- Transfers made by enforceable promise to the extent they remain unsatisfied at death;
- Transfers described in § 25.2701-5(a)(4) or § 25.2702-6(a)(1) and
- Transfers that would have fallen into the above three categories but for the transfer, relinquishment or elimination of an interest, power or property within 18 months of the decedent's date of death, whether exercised by the decedent alone or in conjunction with another person or persons.

Thus, while the emphasized language from the Preamble to the Final Regulations (cited above) states an intent to create an "anti-abuse" provisions, the Boomerang Clawback Regulations instead seem to create an alternate regime for certain gifts, such that if a taxpayer wants to take advantage of the increased BEA, all ties must be severed to the gift. Put differently, any transfer in which the taxpayer does not sever all ties to the property being transferred is not a "bona fide" or "true" inter vivos gift to which the Special Rule should be applied.

We respectfully question whether such an alternate regime should be applied to structures that are compliant with the provisions of Chapter 14 of the Code as a matter of policy. Specifically, even if a taxpayer structures a gift transaction that is expressly carved out as a safe harbor from the rules of Chapter 14 (such as a Qualified Personal Residence Trust ("QPRT") or a grantor retained annuity trust ("GRAT")), the Boomerang Clawback Regulations would prevent taxpayers from availing themselves of the increased BEA. It does not seem logical that permissible, safe-harbor transactions (e.g., QPRTs and GRATs) are the types of transfers to which an "anti-abuse" regulation should be applied. In fact, the enactment of Chapter 14 by Congress in 1990 makes it clear that all retained interests other than retained annuity interests and unitrusts interest, e.g., QPRTs and GRATs, are to be valued at zero, thus implicitly recognizing annuity and unitrust interests as real and substantial transactions, so we question why the IRS is now asserting that they are an appropriate subject for an anti-abuse regulation.

Furthermore, we believe it is important to note that retained interests causing estate tax inclusion ("strings") do not necessarily provide financial value to the donor. Therefore, to take the position that every retention of a string by a taxpayer who has gratuitously transferred property means that the taxpayer has not really parted with anything, such that the taxpayer has not actually made a bona fide gift, despite the requisite donative intent and lack of any consideration, overstates the case. If anything, the taxpayer has suffered a financial detriment, by forgoing the use of the BEA and increased BEA (which will not be restored for many years), thereby foreclosing other planning opportunities. The potential loss of exemption is a very real detriment that is being brushed aside by labeling this type of gift as not "bona fide."

For example, suppose a taxpayer who has previously used $7,000,000 of BEA, transfers in 2022 stock worth $5,060,000 to a trust that will distribute the income to the taxpayer for the taxpayer's lifetime. Section 2702 provides that the value of the retained income interest is zero, thus the taxpayer has made a $5,060,000 gift and at the taxpayer's death the stock will be included in the taxpayer's estate. Section 2001(b) excludes from the operation of section 2001 any gifts that are included in the decedent's gross estate, thus the gift of $5,060,000 will not be considered when calculating the taxpayer's estate tax. If the amount of the BEA at the taxpayer's death is less than $12,060,000, then the taxpayer will have lost the use of the increased BEA. This lifetime gift seems to be the equivalent of a testamentary transfer and thus within the scope of the language from the Preamble cited above, thus the application of Boomerang Clawback seems appropriate.

In contrast, suppose in June 2022 a 65-year-old taxpayer who has previously used $7,000,000 of BEA transfers to a QPRT with a five-year term a personal residence worth $6,638, 678. The taxpayer's gift will be reduced by two retained rights, per section 2702: the right to live in the residence for five years, and the five-year reversionary right, with the resulting gift being $5,060,000. If the taxpayer died within the five-year term of the retained interests, the personal residence would be included in the taxpayer's estate and the gift of $5,060,000 would be excluded from the taxpayer's adjusted taxable gifts by Section 2001(b). Unlike the simple gift in the previous paragraph, the gift to a QPRT is not the equivalent of a testamentary transfer: when making the gift, the taxpayer relied on the reduction in the value of the gift by the two retained rights as specifically provided for by section 2702. Applying Boomerang Clawback to this situation seems unfair. Instead, ACTEC proposes that, in this situation, the taxpayer should be allowed the benefit of the increased BEA available at the time of the original gift. However, ACTEC also observes that a QPRT in which rights to a personal residence are retained for a term exceeding the grantor's life expectancy would appear to be equivalent to a testamentary transfer. For example, if the 65-year-old taxpayer above created a QPRT with a 35-year term then the 2022 gift would be approximately $35,000. If the taxpayer died within the 35-year term, ACTEC would support applying Boomerang Clawback with respect to the QPRT.

2. <u>Clarification Regarding Application of Boomerang Clawback to Notes Outstanding at Death and Examples 1, 2, and 3</u>

The Boomerang Clawback Regulations specifically address transfers made by enforceable promise to the extent they remain unsatisfied as of the date of death. We respectfully request clarification and additional guidance concerning the transfer of enforceable promises.

First, § 20.2010-1(c)(3)(i)(B) of the Boomerang Clawback Regulations is consistent with the reasoning set forth in the Preamble thereto *only if* the transfer of an enforceable promise is a completed gift under § 2511 but nevertheless treated as includible in the gross estate (rather than as an adjusted taxable gift). This seems to be consistent with the reasoning of Revenue Ruling 84-25 that (i) if a donor gratuitously transfers a promissory note, which represents the donor's legally enforceable promise, for less than adequate and full consideration in money or money's worth, the donor has made a completed gift; but (ii) to the extent the note remains unpaid at the donor's death, the assets that are to be used to satisfy the note are part of the donor's gross estate, and therefore the note is deemed to be includible in the donor's estate under Section 2001. The reasoning set forth in Revenue Ruling 84-25 relies on several key assumptions:

1. The promise to pay is enforceable under state law;
2. The promise to pay is a completed gift;
3. The promise to pay is made by the donor (*i.e.*, the donor is the payor);
4. The transfer of the enforceable promise to pay was gratuitously made (*i.e.*, a gift);
5. The assets available to satisfy the promise to pay are part of the donor's estate and
6. The promise to pay remains unsatisfied (or partially unsatisfied) at the time of the donor's death.

Example 1 addresses assumptions 2, 4, 5 and 6, but the Example could be improved by stating in the facts that A's promissory note is enforceable under applicable state law. Pursuant to the reasoning set forth in Revenue Ruling 84-25, the gratuitous transfer of an unenforceable promise to pay is not a completed gift.

The wording of § 20.2010-1(c)(3)(i)(B) of the Boomerang Clawback Regulations seems overly broad in that it is not limited to "gratuitous" transfers or transfers "other than for money or money's worth." The plain reading of § 20.2010-1(c)(3)(i)(B) suggests that it would apply to any transfer made by enforceable promise to the extent it remains unsatisfied as of the date of death. Consider, however, a taxpayer who purchases assets from his or her trust in exchange for a promissory note having the same fair market value as the assets. The value represented by the note was transferred to the trust by an enforceable promise to pay, but that value was received by the trust for adequate and full consideration in money or money's worth. Clarification should be provided that this note, which represents an obligation of the transferor and, to the extent any part of the note remains outstanding at death, would be satisfied from assets in the transferor's gross estate, is not subject to Boomerang Clawback.

If, however, the fair market value of the note exceeded the value of the property at the time the note was executed, clarification should be provided that a portion of the note representing the amount paid in excess of the fair market value of the assets received, *i.e.*, the gift amount, would be subject to Boomerang Clawback, while the balance of the note (the portion representing the amount paid equal to the fair market value of the assets received, *i.e.*, the sale amount) would not be subject to Boomerang Clawback.

Clarification is also sought regarding Example 3. That Example states, in part, that "[b]ecause A's DSUE amount was sufficient to shield the gift of the note from gift tax, no basic exclusion amount was applicable to [this gift] . . . and the special rule of paragraph (c) of this section does not apply to that gift." This Example seems to illustrate the position that transfers made by enforceable promise to pay, to the extent they remain unsatisfied as of the date of death, *will not* be eligible for the Special Rule if the BEA applied to such transfers, but *will* be eligible for the Special Rule if DSUE applied to such transfers. Treating these situations differently does not seem consistent with the reasoning set forth in the Preamble to the Boomerang Clawback Regulations.

3. **<u>Additional Guidance Needed Concerning Application of Boomerang Clawback to Section 2701 Interests</u>**

We respectfully request that additional guidance be provided concerning the exception to the Special Rule for transfers described in §25.2701-5(a)(4) ("Section 2701 Interests")[3] and that examples be added to the Boomerang Clawback Regulations that specifically address Section 2701 Interests.

Prop. Reg. §20.2010-1(c)(3)(i) provides, in pertinent part, that "[e]xcept as provided in paragraph (c)(3)(ii) of this section, the Special Rule of paragraph (c) of this section does not apply to transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b), including without limitation the following transfers: . . . *(C) Transfers described in §25.2701-5(a)(4) or §25.2702-6(a)(1)*[4] *of this chapter . . . ."* (*emphasis* added)

As Prop. Reg. §20.2010-1(c)(3)(i) currently reads, it is not clear whether the provisions would apply only with respect to transfers in which the "zero valuation" rule under §25.2701-1(a)(2) and §25.2701-2(a) *is applicable* (*emphasis* added) in determining the value ascribed to an applicable retained interest, OR, if the provisions would also apply in any situation in which the value ascribed to an applicable retained interest is merely *determined* using the special valuation rules of Section 2701. For instance, if the applicable retained interest is not subject to the "zero valuation" rule under §25.2701-1(a)(2)(ii) because the right is a qualified payment right, the interest is still "determined" under the special valuation rules of Section 2701. Additionally, clarification is requested with respect to the above proposed language wherein reference is made to "transfers *described in* 25.2701-5(a)(4)" (*emphasis* added), since §25.2701-5(a)(4) does not actually *describe* specific "transfers", but, rather, provides a *definition* of a "Section 2701 interest" as being "… an applicable retained interest that was valued using the special valuation rules of section 2701 at the time of the initial transfer…"

ACTEC requests clarification for two scenarios. First, either a distribution right or an extraordinary payment right associated with an applicable retained interest is valued at zero under §25.2701-1(a)(2) and §25.2701-2(a), thereby resulting in a deemed gift with respect to the

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[3] Treas. Reg. §25.2701-5(a)(4) provides:

> (4) Section 2701 interest – A section 2701 interest is an applicable retained interest that was valued using the special valuation rules of section 2701 at the time of initial transfer. However, an interest is a section 2701 interest only to the extent the transfer of that interest effectively reduces the aggregate ownership of such class of interest by the initial transferor and applicable family members of the initial transferor below that held by such persons at the time of the initial transfer (or the remaining portion thereof).

[4] Treas. Reg. §25.2702-6(a)(1) provides:

> (1) Inter vivos transfers. If an individual subsequently transfers by gift an interest in trust previously valued (when held by that individual) under §25.2702-2(b)(1) or (c), the individual is entitled to a reduction in aggregate taxable gifts. The amount of the reduction is determined under paragraph (b) of this section. Thus, for example, if an individual transferred property to an irrevocable trust, retaining an interest in the trust that was valued at zero under §25.2702-2(b)(1), and the individual later transfers the retained interest by gift, the individual is entitled to a reduction in aggregate taxable gifts on the subsequent transfer. For purposes of this section, aggregate taxable gifts means the aggregate sum of the individual's taxable gifts for the calendar year determined under section 2502(a)(1).

transferor's retained preferred equity interest. Second, the transferor's distribution right is structured as a qualified payment right (or a qualified payment right election is made on the transferor's gift tax return pursuant to Section 2701(c)(3)(C)(ii) and Treas. Reg. §25.2701-2(c)(2)) so that the zero-valuation rule under §25.2701-1(a)(2) and §25.2701-2(a) does not apply. Clarification is requested as to the meaning of "(C) Transfers described in §25.2701-5(a)(4)" as included in the Boomerang Clawback Regulations.

In addition, while transfers described in Treas. Reg. §25.2702-6(a)(1) – and specifically, GRATs – are addressed at length in Examples 4, 5 and 6 of the Boomerang Clawback Regulations, none of the examples address preferred partnership structures or Section 2701 Interests. Nonetheless, the Boomerang Clawback Regulations and the Preamble thereto refer to situations in which Section 2701 Interests could give rise to Boomerang Clawback. Accordingly, it would be very helpful if the examples in the Boomerang Clawback Regulations were expanded to address Section 2701 Interests as well. These examples could be focused on the following:

- To provide clarification concerning the appropriate treatment in the case of preferred partnership interests that do not meet the definition of a "qualified payment" under Section 2701(a)(3)(A), Treas. Reg. §§25.2701-2(a)(2) and 25.2701-2(b)(6), for which qualified payment treatment has NOT been elected on a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return pursuant to Section 2701(c)(3)(C)(ii) and Treas. Reg. §25.2701-2(c)(2), so as to result in the preferred partnership interest being subject to "zero valuation" rule under §25.2701-1(a)(2) and §25.2701-2(a), and resulting in a taxable gift utilizing some or all of the transferor's BEA.
- To provide clarification concerning the appropriate treatment in the case of preferred partnership interests that do not meet the definition of a "qualified payment" under Section 2701(a)(3)(A), Treas. Reg. §§25.2701-2(a)(2) and 25.2701-2(b)(6), but for which qualified payment treatment has nevertheless been elected on a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return pursuant to Section 2701(c)(3)(C)(ii) and Treas. Reg. §25.2701-2(c)(2).
- To provide clarification that Boomerang Clawback does ***not*** apply to interests that are beyond the scope of Treas. Reg. §25.2701-5(a)(4), such as:
    - transfers of partnership interests that qualify for the "proportionate transfer" or "vertical slice" exception to Section 2701 pursuant to Treas. Reg. §25.2701-1(c)(4);
    - rights to guaranteed payments of a fixed amount under Section 707(c) as described in Treas. Reg. §25.2701-2(b)(4)(iii);[5] and
    - mandatory payment rights as described in Treas. Reg. §25.2701-2(b)(4)(i).

4. **<u>Boomerang Clawback and the Eighteen Month Rule and Example 7</u>**

[5] See Smaldino v. Comm'r, T.C. Memo. 2021-127, at 35 (Tax Ct. 2021) ("`[A]ny right to receive any guaranteed payment described in section 707(c) of a fixed amount' is not a `distribution right.' Sec. 2701(c)(1)(B)(iii). Hence, such a right is not an `applicable retained interest' within the meaning of Section 2701(b)(1), and Chapter 14 does not mandate that it be valued at zero.").

Section 20.2010-1(c)(3)(i)(D) of the Boomerang Clawback Regulations (referred to below as the "18-month rule") provides that the Special Rule does not apply to:

> "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."

The Preamble to the Boomerang Clawback Regulations explains:

> "The exception to the special rule also would apply to transfers that would be described in the preceding sentence but for the transfer, elimination, or relinquishment within 18 months of the donor's date of death of the interest or power that would have caused inclusion in the gross estate, effectively allowing the donor to retain the enjoyment of the property for life. In addition to transfers, eliminations, or relinquishments by the donor, examples include the elimination, by a third party having the power to eliminate or extinguish the interest or power, of the interests or powers that otherwise would have resulted in inclusion of transferred property in the donor's gross estate; the payment of a gift made by enforceable promise as described in Rev. Rul. 84–25, *supra*; and the transfer of a section 2701 interest within the meaning of § 25.2701–5(a)(4) or a section 2702 interest within the meaning of § 25.2702–6(a)(1). For purposes of the preceding sentence, such transfers, eliminations, and relinquishments include those effectuated by the donor, the donor in conjunction with any other person, or by any other person, but do not include those effectuated by the expiration of the period described in the original instrument of transfer, whether by a death or the lapse of time."

ACTEC respectfully suggests that this 18-month rule appears inconsistent with the policy decisions that Congress made when changing Section 2035 over the years. For example, while Section 2035 originally utilized a contemplation of death rule, after litigation Congress changed the approach to a 3-year bright line test. The 18-month rule seems to override Congress' choice.

Further, Section 2035 captures only certain transfers and relinquishments made ***by the decedent***. In contrast, the 18-month rule would include actions taken by persons other than the decedent, *i.e.*, actions that are outside the scope of Section 2035. Similarly, Section 2035 has a specific exception for transfers that qualify as a "bona fide sale for an adequate and full consideration," while the 18-month rule does not appear to contain such an exception. Finally, while Section 2035 had captured Section 2041 relinquishments, Congress later amended Section 2035 to remove relinquishments of Section 2041 powers. Nonetheless, the 18-month rule includes relinquishments of Section 2041 powers, which, again, appears inconsistent.

If the 18-month rule is retained, presumably it would be retained out of concern for the decedent colluding with whoever effectuated the triggering event. If that is the reason, then ACTEC suggests that avoiding litigation over collusion should work both ways – arguments of collusion would not be made for actions within or before the period covered by the 18-month rule.

Looking to Example 7, if a trustee who is not a related or subordinate party, as defined by Section 672(c) with respect to C terminates the GRIT within 18 months before C's death, the 18-month rule would apply to the GRIT, yet Section 2035 would not include that property in C's estate and Revenue Ruling 95-58 would not impute the trustee's powers to C for purposes of Section 2036. Explanation of the effect of the 18-month rule would be helpful.

5. Boomerang Clawback and the Five Percent Safe Harbor

Section 20.2010-1(c)(3)(ii)(A) of the Boomerang Clawback Regulations provides, in part, that the Special Rule applies only to "[T]ransfers includible in the gross estate in which the value of the taxable portion of the transfer, determined as of the date of transfer, was 5 percent or less of the total value of the transfer" ("5 Percent Safe Harbor"). In the Preamble to the Boomerang Clawback Regulations, an explanation of the purpose of the 5 Percent Safe Harbor provides that a "bright line exception" to replace a facts and circumstances determination of whether a particular transfer was intended to take advantage of the increased exemption without depriving the donor of the use and enjoyment of the property."

The Preamble to the Boomerang Clawback Regulations states that the use of the 5 Percent Safe Harbor is to ensure the Special Rule would only apply to transfers includable in the gross estate when the taxable amount of the gift is not material (presumably because if the gift is immaterial, the transfer was not designed to take advantage of the increased exemption without depriving the donor of the use and enjoyment of the property.) The Preamble then states that the 5-percent amount relates to the 5-percent provisions that appear in Section 2037(a)(2), Section 2042(2) and Section 673(a).

We are not convinced that the 5 Percent Safe Harbor serves its stated purpose here. If the purpose of the 5 Percent Safe Harbor is to apply Boomerang Clawback to those transfers where the donor's intention was to take advantage of the increased BEA without giving up use and enjoyment of the property, a test that evaluates the probability of inclusion in the gross estate would achieve that goal better than one that looks only at whether the gift is 5 Percent "of the total value of the transfer." In the event of a very large transfer, the 5 Percent Safe Harbor as proposed could exempt a large transfer without considering whether the donor intended to retain use and enjoyment of the property. Consider, for example, a taxpayer who transfers assets valued at $100 million to a GRAT and retains an interest the actuarial value of which is $95 million, making the gift a gift of 5 percent of the value. Moreover, we have seen multiple legislative proposals trying to force taxpayers to make a larger gift when funding a GRAT. In contrast, under the 5 Percent Safe Harbor, a GRAT with a larger gift as a proportion of the amount transferred would be subject to Boomerang Clawback while one with a gift valued at 5 percent or less of the transfer would not be. While we appreciate the effort to provide a bright line test, ACTEC is not convinced that this rule achieves the objectives set forth in the Preamble to the Boomerang Clawback Regulations.

6. Clarification of Example 4 of the Boomerang Clawback Regulations

The last two sentences of Example 4 of the Boomerang Clawback Regulations ("Example 4") are confusing in light of the language of Example 4 that precedes them. We accordingly request that Treasury either delete the last two sentences of Example 4 or put them in a separate example.

Set forth below is full text of Example 4, with ***emphasis*** on the last two sentences:

"(D) Example 4. Individual B transferred $9 million to a grantor retained annuity trust (GRAT), retaining a qualified annuity interest within the meaning of §25.2702-3(b) of this chapter valued at $8,550,000. The taxable portion of the transfer valued as of the date of the transfer was $450,000. B died during the term of the GRAT. The entire GRAT 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 5 percent or less 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 met and the exception to the special rule found in paragraph (c)(3) of this section does not apply to the gift. ***However, because the total of the amounts allowable as a credit in computing the gift tax payable on B's post-1976 gift of $450,000 is less than the credit based on the $6.8 million basic exclusion amount allowable on B's date of death, the special rule of paragraph (c) of this section does not apply 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 use of the word "[h]owever" at the beginning of the second to last sentence of Example 4 is confusing because it suggests that the last two sentences of the example reach a different conclusion than the earlier sentences. As written, the last two sentences seem to provide an alternative (and superfluous) reason for reaching the same result. ACTEC would suggest illustrating the point that there is no Boomerang Clawback when the taxpayer's gifts don't exceed the BEA in effect at the date of gift in a separate example that cannot be resolved with the 5 Percent Safe Harbor.

7. Request For Additional Example of Application of Boomerang Clawback

We respectfully request an additional variation on Example 7. Specifically, suppose taxpayer created a GRIT in 2013, before the increased BEA was even contemplated, and funded it with $5 million. In 2020, the taxpayer made an outright gift to the taxpayer's children to use the remaining BEA and increased BEA. Proposed § 20.2010-1(c)(3) would appear to deny the use of the bonus exclusion amount with respect to the GRIT, even though the taxpayer created the GRIT well before the concerns described in the Preamble to the Boomerang Clawback Regulations could ever have been considered. ACTEC does not believe Boomerang Clawback should apply to such a fact pattern.

8. Boomerang Clawback and Generation Skipping Transfer ("GST") Tax Considerations

Although in the Preamble to the Final Regulations Treasury indicated that guidance regarding the GST tax consequences of the Special Rule were beyond the scope of the Final Regulations, we respectfully request that guidance be given on this issue. Specifically, does Boomerang Clawback apply for GST tax purposes, such that any allocation of GST tax exemption made concurrent with usage of the increased BEA amount is rescinded? In addition, if a transfer reported as a gift on Form 709 is later determined to be includible in the gross estate, e.g., pursuant to § 2036, giving rise to an estate tax inclusion period ("ETIP"), what is the effect on the transferor's original allocation of GST tax exemption, given that such an allocation is not effective until the end of the ETIP pursuant to § 26.2632-1? Finally, what is the impact of the 18-month period described in Prop. Reg. § 20.2010-1(c)(3)(D) on the allocation of GST exemption?