ACTEC
THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL

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Please Address Reply to:

Executive Director
DEBORAH O. McKINNON

May 29, 2026
Submitted Electronically via the Federal eRulemaking Portal at https://www.regulations.gov (IRS-2026-0364)

Internal Revenue Service
Attn: CC:PA:01:PR (Notice 2026-23)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendations of The American College of Trust and Estate Counsel ("ACTEC") for Items to Include on Treasury's 2026-2027 Priority Guidance Plan

On March 23, 2026, the U.S. Department of the Treasury and the Internal Revenue Service ("IRS") (collectively "Treasury") released Notice 2026-23 [1] (the "Notice") inviting the public to submit recommendations for items to be included on the 2026-2027 Priority Guidance Plan (the "Priority Guidance Plan"). The Priority Guidance Plan will identify guidance projects that Treasury intends to actively work on as priorities during the period from July 1, 2026 through June 30, 2027.

ACTEC recommends that the following items be included on the Priority Guidance Plan, and elaborates on these items in the accompanying memorandum. We first address those items which arise under the act "*To provide for reconciliation pursuant to title II of H. Con. Res. 14.*" (the "Act" or "OBBBA"),[2] which was enacted on July 4, 2025. We then address certain additional items.

Items arising under the OBBBA

1. Provide guidance under Section[3] 68 dealing with the overall *Limitation on Itemized Deductions*, both generally and as it pertains to its application to trusts and estates.

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1 Notice 2026-23 can be found at the following link: https://www.irs.gov/pub/irs-drop/n-26-23.pdf

2 P.L. 119-21. The Act's short title was the "One Big Beautiful Bill Act." The Act's short title was removed as extraneous.

3 Unless otherwise stated, references in this memorandum to "Code" are to the Internal Revenue Code of 1986, as amended. References in this memorandum to "section(s)" are to sections of the Code.

2. Provide guidance under Section 530A dealing with *Trump Accounts*, as it pertains to the gift and generation-skipping transfer tax treatment of contributions to these accounts.

3. Provide guidance under Section 1202 dealing with *Qualified Small Business Stock*, in various respects.

Additional Items

4. Provide guidance under Section 6035 and under Reg. § 1.6035-1(h) dealing with the reporting requirement that is imposed upon trustees of certain trusts concerning the basis of certain property acquired from a decedent.

5. Provide guidance under sections 402(c) and 408(d) dealing with spousal rollovers of qualified retirement plan and individual retirement account (IRA) benefits where an estate or trust is the beneficiary of a decedent's interest and such benefits are distributed to the surviving spouse under the decedent's estate plan.

6. Provide guidance dealing with the issues relating to foreign trusts that are described below.

   a. Clarification of how section 679 applies to transfers made by a trustee of a domestic nongrantor trust (a "transferor") to the trustee of a foreign trust that would not be a grantor trust but for the possible application of section 679. Will the domestic trust be considered to "own" the assets of the foreign trust (assuming that the domestic trust has not terminated)?

   b. Determine whether the last sentence of Reg. § 1.672(f)-3(a)(1) preventing a foreign revocable trust from being treated as a grantor trust if, in any prior year, the trust was not revocable is a valid exercise of regulatory authority. *See also* example 3 of §1.672(f)-3(b)(4)(dealing with amounts temporarily distributable to someone other than the grantor or the grantor's spouse disqualifying the trust as a grantor trust even after the interest of such person is terminated.)

   c. Clarification as to whether section 684 applies to the migration of a US trust whose grantor was a foreign person. Reg. § 1.684-4(a) implies that the section applies only if the trust was funded by a US person.

References in this memorandum to "Reg. §" are to relevant sections of the Treasury regulations promulgated under the Code.

7. Provide guidance under section 671 as to how the income of a grantor trust with more than one grantor should be allocated among the different grantors and whether a grantor trust with more than one grantor can be severed into separate trusts each of which would be treated as having a separate grantor.

8. Provide guidance under section 7701 regarding the tax classification of purpose trusts, and functionally similar structures, for federal income tax purposes.

9. Provide guidance under section 2036 that would (a) prevent gross estate inclusion for retained powers the exercise of which is subject to a contingency beyond the control of the decedent, (b) prevent gross estate inclusion for retained powers over a trust or entity that can be exercised only with the consent of all persons with beneficial interests in the trust or entity that add nothing to the powers that the decedent would have had under local law without an express retention, and (c) prevent double inclusion of the value of transferred interests and the decedent's ownership interest in the trust or entity to which the transfers were made.

10. Consider repealing certain regulations under section 2701 which seem to impermissibly expand the statutory rules.

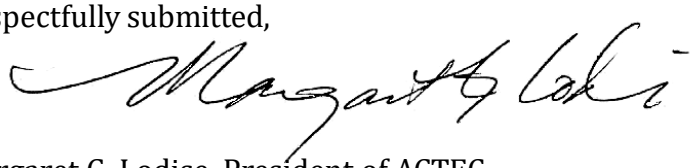
11. Consider repealing certain regulations under section 2702 which seem to impermissibly expand the statutory rules as they relate to grantor retained annuity trusts, personal residence trusts and qualified personal residence trusts.

We thank Treasury for the opportunity to submit these recommendations, and would welcome the opportunity to discuss these recommendations further with Treasury.

ACTEC is a nonprofit association of lawyers and law professors. Its more than 2,300 members are called "Fellows" and practice throughout the United States, Canada, and other foreign countries, with extensive experience in the preparation of wills and trusts, estate planning, and administration of trusts and estates of decedents, minors, and incompetents. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar association activities. Fellows of ACTEC also have extensive experience in matters pertaining to business entities. These comments were prepared by members of ACTEC's Washington Affairs Committee, Executive Committee, Estate and Gift Taxation Committee, Business Planning Committee, International Estate Planning Committee, Fiduciary Income Taxation Committee and Employee Benefits Committee. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

ACTEC's recommendations are set forth in the attached memorandum. If you or your staff would like to discuss the contents of this memorandum with the ACTEC Fellows who created it, please contact Kevin Matz, Chair of ACTEC's Washington Affairs Committee (212-745-9546, Kevin.matz@afslaw.com), or Deborah McKinnon, ACTEC Executive Director (202-684-8460, domckinnon@actec.org).

Respectfully submitted,



Margaret G. Lodise, President of ACTEC

ACTEC President 2026–2027

Recommendations of The American College of Trust and Estate Counsel ("ACTEC")
For Items to Include on Treasury's 2026-2027 Priority Guidance Plan

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We thank Treasury for the opportunity to submit these recommendations and would welcome the opportunity to discuss these recommendations further with Treasury.

Items arising under the OBBBA

We have indicated within this portion of our recommendations relating to changes to the Code made by the OBBBA (the "Act") **(i)** where technical corrections via congressional action may be warranted (which is the default approach suggested in these recommendation except where otherwise indicated), and **(ii)** where issues may potentially be addressed through regulations or other guidance issued by Treasury (which we have denoted through the use of italics with blue font).

I. Request for Guidance Concerning section 68 Overall Limitation on Itemized Deductions

A. Background

The operation of the former version of section 68, which imposed a limitation on the amount of certain itemized deductions allowed to taxpayers whose adjusted gross income exceeded certain levels, was suspended by the 2017 Tax Cuts and Jobs Act (the "TCJA") for the years 2018 through 2025. This limitation was commonly referred to as the "Pease" limitation. The former Pease limitation did not apply to estates and trusts. The Act permitted the suspension of the Pease limitation to expire but amended the section in the following three significant ways:

1. New section 68 caps the tax reducing value of the deductible itemized deductions at 35%. The new version does this by requiring a taxpayer to reduce the amount of his or her itemized deductions by 2/37ths of the lesser of (i) the amount of all of his or her itemized deductions or (ii) the excess of his or her taxable income, computed without reducing the taxpayer's adjusted gross income by his or her itemized deductions, over the dollar amount at which the 37% tax bracket begins to apply.

2. The limitation now applies to medical deductions, the deduction for investment interest, and the deduction for certain casualty or theft losses. These deductions were excluded from the former version of section 68.

3. Estates and trusts are no longer excluded from the operation of section 68.

B. Problems

New section 68 has two main problems:

1. The new 2/37 reduction is not limited to taxpayers who have income that is subject to a 37% tax rate — for instance, all of a taxpayer's income could be long-term capital gains or qualified dividends taxable at a 20% tax rate. The application of section 68 to these taxpayers appears inconsistent with the legislation's stated intent.

2. The extension of section 68 to estates and trusts may result in the disallowance of deductions that are unique to estates and trusts and that don't apply to individuals. Section 68 applies to individuals and section 641(b) taxes estates and trusts as individuals "***except as otherwise provided in this part***." Some provisions of part 1 of Subchapter J, such as sections 651, 661 and 642(c), although called "deductions" are more in the nature of allocations of income to beneficial owners, particularly where distributions are mandated (such as in the case of the termination of an estate or trust or a charitable lead trust that is required to distribute income to charity). Similarly, the deduction for the administration expenses of estates and nongrantor trusts that are not commonly or customarily incurred by individuals is particular to the calculation of income of a trust or estate and expressly

inapplicable to individuals. In some cases, applying section 68 to estates and trusts may cause double taxation.

Each of these issues is discussed below together with possible solutions.

C. Application to taxpayers whose income is not taxed at 37%

1. The Problem

Section 68(a), "In general," provides:

> In the case of an individual, the amount of the itemized deductions otherwise allowable for the taxable year (determined without regard to this section) shall be reduced by 2/37 of the lesser of -
>
> (1) such amount of itemized deductions, or
>
> (2) so much of the taxable income of the taxpayer for the taxable year (determined without regard to this section and increased by such amount of itemized deductions) as exceeds the dollar amount at which the 37 percent rate bracket under section 1 begins with respect to the taxpayer.

Section 1(h) provides that a taxpayer's "adjusted net capital gain," which is defined to include qualified dividend income, is taxed at various rates, from 20% to 28%.

The Staff of the Joint Committee on Taxation summarized the proposed new section 68 in JCX-21-25 (May 12, 2025):

> This provision permanently repeals the Pease limitation and replaces it with a new overall limitation on the tax benefit of itemized deductions, applicable to individuals, estates, and trusts. For a taxpayer with taxable income that, before reduction for itemized deductions, exceeds the dollar amount at which the 37-percent tax rate bracket begins, this provision generally caps the tax-reducing value of each dollar of otherwise allowable itemized deductions at 35 cents. This new limitation is effective for taxable years beginning after December 31, 2025.

The Senate Finance Committee's summary (released after the Act was enacted) states:

> This provision permanently repeals the Pease limitation and replaces it with a new overall limitation on the tax benefit of itemized deductions, applicable to individuals, estates, and trusts. For a taxpayer with taxable income that, before reduction for itemized deductions, exceeds the dollar amount at which the 37-percent tax rate bracket begins, this provision generally caps the tax-reducing value of each dollar of otherwise allowable itemized deductions at 35 cents. This new limitation is effective for taxable years beginning after December 31, 2025.

2. Possible solution

If Congress did not intend the section 68 limitation to apply to income not taxed at the 37% rate, it could consider a technical amendment to section 68(a)(2) that would read as follows:

> "(2) so much of the taxable income of the taxpayer for the taxable year (determined without regard to this section and increased by such amount of itemized deductions) reduced by the amount of the taxpayer's income subject to tax under section 1(h)".

Alternatively, the Treasury could consider issuing guidance clarifying how section 68(a)(2) should be applied in the context of section 1(h), considering the apparent legislative intent as described in JCX-21-25 and the Senate Finance Committee's summary.

D. Overbroad application to estates and trusts

1. The problem

Like former section 68, new section 68 specifically applies only "In the case of an individual." While former section 68(e) provided a special exception for estates and trusts, that subsection was repealed by the Act. Accordingly, without such an exception, section 68 may be construed to apply to estates and trusts based on the following:

- Section 63(d) defines itemized deductions for all purposes of the income tax as all the deductions allowed to taxpayers other than deductions listed in section 63(b) and deductions that are allowed in calculating adjusted gross income. The deductions allowed by sections 642(c), 651, and 661, and the deductions for administration expenses, are not listed in section 63(b), and they are not deductions that are allowed in calculating adjusted gross income as defined in section 62, which defines the adjusted gross income of an individual. The deductions under sections 651 and 661, and the deduction for trust or estate administration expenses, are allowable in determining the adjusted gross income of a trust or estate under section 67(e), although this section by its terms applies only for purposes of section 67. And while Regulation § 1.67-4(a)(ii) specifically states that section 651 and 661 deductions and administration expenses that are not commonly or customarily incurred by individuals "are not itemized deductions under section 63(d)," that regulation may be applicable only for purposes of section 67. Accordingly, the deductions under sections 651, 661 and 642(c) may be subject to the limitation of section 68.

- Section 641(b) states, "The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part." A major question about new section 68 in the context of section 641 is whether it should apply only to estate and trust deductions that are "in the same manner as in the case of an individual," or whether it also should impact those special deductions in Subchapter J that apply only to estates and trusts and not to individuals – the "except as otherwise provided in this part."

Under Subchapter J of the Code, the ways in which most estates and trusts calculate their income tax differ from the way individuals calculate their income tax primarily in three ways:

- First, estates and trusts serve partially as conduits:

    - "Deductions" allowed to estates and trusts under sections 651, 661 and 642(c) function as a mechanism to attribute income from the estate or trust to the beneficial owners of such income, particularly in the case of an estate or trust that is making liquidating distributions to beneficial owners and charitable lead trusts making mandatory distributions to charity. Applying section 68 to section 651 or 661 may result in double taxation. Any amount that a trust or estate deducts under section 651 or 661 is included in its beneficiaries' gross income under section 652 or 662. The beneficiaries in turn are subject to the section 68 disallowance of deductions by virtue of including the income from the estate or trust in gross income. Accordingly, if section 68 applies to income from a trust or estate that is distributed to a beneficiary, the income will be subject to the section 68 limitation twice -- by the trust or estate, and by the beneficiaries.

- Consider, for example, a trust with $1 million of gross income and no expenses. It distributes all its income to its beneficiary. The trust has a distribution deduction of $1 million under section 661 but, after application of the section 68 limitation (assuming a trust pays tax at a 37% rate on income above $16,000, as it does in 2026), it will pay an income tax of $17,611 on taxable income of $53,189. The beneficiary will pay tax on the entire $1,000,000, and the addition of this amount to the beneficiary's gross income will result in his or her deductions also being subject to the section 68 limitation.

  - When an estate or trust distributes its gross income to charity and that distribution is authorized by the governing instrument, conduit treatment is effected through section 642(c) rather than through section 661. Section 642(c) prevents an estate or trust from being taxed on the amount of gross income that is distributed to charitable beneficiaries. Section 663(a)(2) recognizes that section 642(c) takes the place of any section 661 deduction.

- Second, estates and post-mortem revocable trusts distribute all of their assets to their beneficiaries over a relatively short period of time and may recognize associated income – including income in respect of a decedent under section 691 – in lump sums that represent substantially more than a single year's earnings. In contrast, an individual's income tax return generally reports income from a single year's earnings.

  In addition to estates and post-mortem revocable trusts, charitable lead trusts often pay a large portion of their assets to charity, often distributing assets having an actuarial value equal to the value of the trust at the time of its funding. Revenue Procedure 2007-46 provides sample testamentary charitable lead annuity trust provisions and in section 5.01(2) explains the section 642(c)(1) charitable deduction in that context.

- Third, estates and trusts incur expenses that are unique to the administration of trusts and estates and that are not commonly or customarily incurred by individuals.

2. Possible solutions

a. Solution to limit the application of section 68 to deductions applicable to individuals

If Congress did not intend the section 68 limitation to apply to the unique deductions for estates and trusts under Subchapter J of the Code, it could consider a technical amendment of section 68 to clarify that it only applies to deductions that would be computed in the same manner as in the case of an individual, and not to deductions that only apply to estates and trusts as otherwise provided in Subchapter J of the Code. In addition to the deductions to which section 67(e) refers, we think the deduction allowed by section 642(c) should also be expressly excepted from the application of section 68, particularly in the case of mandatory and liquidating distributions.

Alternatively, Treasury could consider issuing guidance under section 68 providing that it only applies in the case of an estate or trust to deductions that would otherwise apply in the case of an individual.

b. Solution to the double taxation problem

Subsection (e) of section 67, which disallows the deductibility of a large category of itemized deductions referred to as "miscellaneous itemized deductions," recognizes the uniqueness of the section 651 and 661

deductions and the deduction for the unique administration expenses of trusts and estates. It provides as follows:

> For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that -
>
> (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate, and
>
> (2) the deductions allowable under sections 642(b), 651, and 661,
>
> shall be treated as allowable in arriving at adjusted gross income. Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter to take into account the provisions of this section.

Unfortunately, section 67(e) begins by saying that its modification of AGI applies only for purposes for section 67.

The regulations under section 67, however, do not limit the application of section 67(e) to section 67. Instead, they provide:

> (1) Section 67(e) deductions.
>
> (i) *In general*. An estate or trust (including the S portion of an electing small business trust) not described in §1.67-2T(g)(1)(i) (a non-grantor trust) must compute its adjusted gross income in the same manner as an individual, except that the following deductions (section 67(e) deductions) are allowed in arriving at adjusted gross income:
>
> (A) Costs that are paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in such estate or trust; and
>
> (B) Deductions allowable under section 642(b) (relating to the personal exemption) and sections 651 and 661 (relating to distributions).
>
> (ii) *Not disallowed under section 67(g)*. Section 67(e) deductions are not itemized deductions under section 63(d) and are not miscellaneous itemized deductions under section 67(b). Therefore, section 67(e) deductions are not disallowed under section 67(g).

If Congress did not intend the section 68 limitation to apply to the unique administration expenses of estates and trusts or to the deductions allowed by sections 651 and 661, it could consider a technical amendment of section 67(e) to provide that it applies for purposes of section 68 as well as for purposes of section 67.

Alternatively, Treasury could consider issuing guidance under section 68 providing that for purposes of determining the adjusted gross income of an estate or trust, the adjusted gross income of an estate or trust is adjusted gross income as defined in section 67(e). There is precedent for a regulation to reference section 67(e)

for guidance as to how to calculate the adjusted gross income of an estate or trust. For example, the regulations under section 30D dealing with the clean vehicle credit provide, without any direction in the Code, that estates and trusts should calculate their modified gross income in the same manner that they calculate their adjusted gross income under section 67(e). (Reg. § 1.30D-2(b)(32)(ii))

c. Solution to the section 642(c) deduction issues

Section 642(c)(1) provides that the charitable deduction for gross income paid to charity is "without limitation." Section 642(c)(2) similarly provides that the charitable deduction for amounts permanently set aside for charity by an estate or by a trust that is treated as part of an estate is "without limitation." Regulation §§ 1.642(c)-1(a)(1) and 1.642(c)-2(a) recognize that the section 642(c) deduction is "in lieu of the limited charitable contributions deduction authorized by section 170(a)." This "without limitation" provision that applies to trusts and not to individuals originated in section 162(a) of the 1939 Internal Revenue Code, as explained by the U.S. Supreme Court in *United States v. Benedict*, 338 U.S. 692 (1950). Given that the section 642(c) is fundamentally different for estates and trusts from the section 170(a) deduction for individuals, it is possible that Congress did not intend section 68 to limit section 642(c)(1) and (2) deductions.

If Congress did not intend the section 68 limitation to apply to the deduction allowed to estates and trusts for their payments from gross income to charity and their permanent set asides from gross income for charity, it could consider a technical amendment to section 67(e) to add the section 642(c) deduction to the list of deductions trusts and estates take in computing adjusted gross income. That technical amendment, together with the one suggested above in connection with the section 651 and 661 deductions and the unique administration expense deductions of trusts and estates, would ensure that the section 642(c) deduction would not be subject to the section 68 limitations.[4]

Alternatively, Treasury could consider issuing guidance under section 68 to resolve the ambiguity in the Code by either providing that the "without limitation" language in section 642(c) takes precedence over section 68 or that section 68 takes precedence over the "without limitation" language in section 642(c).

If that approach is not taken then we have an additional point to consider. As mentioned above, an estate and a post-mortem revocable trust distribute all their assets to their beneficiaries over a relatively short period of time and report associated income – including income in respect of a decedent under section 691 – often in lump sums that represent substantially more than a single year's earnings. In contrast, an individual's income tax return generally reports income from a single year's earnings. If an estate or post-mortem revocable trust distributes all its gross income to charity, imposing income tax would contravene the public policy favoring charitable deductions described in *Benedict*. Furthermore, *Hartwick College v. United States*, 801 F.2d 608 (2nd Cir. 1986), suggests that Congress generally does not intend to limit section 642(c) deductions the way that Congress intended to limit section 2055 deductions.

Lastly, if section 68 does apply to section 642(c) deductions, there is some uncertainty as to how to calculate the amount of the section 642(c)(2) set aside deduction. If the income tax caused by the disallowance under section 68 of a portion of the charitable deduction reduces the amount of the set aside deduction, the calculation of the amount of the deduction could require a complicated interrelated set of calculations

[4] Implementing this proposal could have collateral consequences, including under sections 1411(a)(2)(B)(i) and 6654(d)(1)(C)(iii).

involving two unknown but related variables. Per *Edwards v. Slocum*, 264 U.S. 61 at 63, 44 S.Ct. 293 at 293 (1924) cited in *Hartwick College,* "algebraic formulae are not lightly to be imputed to legislators." This problem does not arise in connection with the section 642(c)(1) deduction because the amount of that deduction is limited to the amount actually paid to charity. The fact that the trust may have to pay income tax on a portion of what it paid to charity will not reduce the amount of the section 642(c)(1) deduction.

The decision in *Hartwick College* permits the section 642(c)(2) deduction to be calculated without reduction for income taxes that might be imposed on the amount set aside. In that case, the income taxes to which the set aside amount was subject were caused by the use of income to pay administration expenses that were deducted for estate tax purposes. *We recommend that Treasury issue guidance consistent with that decision explicitly permitting the amount of the section 642(c)(2) deduction to be calculated without reduction for any income tax caused by the section 68 disallowance. That would mean, for example, that an estate with gross income of $1,000,000 the only beneficiary of which is charity would be treated as having permanently set aside $1,000,000 for charity despite the fact that the amount that is ultimately available for charity would be reduced by the income tax caused by the reduction under section 68 of the size of the section 642(c)(2) deduction*.

II. Request for Guidance Concerning the Gift and Generation-Skipping Transfer Tax Treatment of Contributions to Trump Accounts

A. Background

The Act provides for the creation of "Trump accounts" to encourage saving for a child's future. The provisions relating to Trump accounts are in section 530A. Section 530A is silent regarding the gift and generation-skipping transfer ("GST") tax treatment of a contribution to a Trump account.

B. Problem

Absent an exclusion, a gift tax is imposed on the transfer of property by gift. Section 2501(a)(1). Exclusions from gift tax treatment are described in section 2503. In particular, section 2503(b) describes the annual exclusion, which is $10,000 per donor per donee as adjusted for inflation. For gifts made in 2025, the annual exclusion is $19,000 per donor per donee. The annual exclusion applies only to gifts that are gifts of "a present interest in property." Section 2503(b)(1).

Absent an exception, a GST tax is imposed on the transfer of property by gift to a skip person (generally a person assigned two or more generations below the transferor such as a grandchild). Sections 2601 and 2612(c). Section 2642(c) provides an exception from the GST tax for gifts which are excludable gifts under section 2503(b). For gifts made in 2026, the amount potentially protected from the GST tax is $19,000 per donor per donee.

When Congress created qualified tuition program accounts ("529 accounts") to provide a savings mechanism for education, the authorizing statute included section 529(c)(2) describing the gift tax consequences of a gift to a 529 account. Section 529(c)(2)(A)(i) provides that for purposes of chapters 12 and 13 (the gift tax and the GST tax, respectively) a contribution to a 529 account on behalf of a designated beneficiary "shall be treated as a completed gift to such beneficiary which is not a future interest in property." This language qualifies contributions to a 529 account for the annual exclusion from gift tax and the GST tax exception.

The legislation enacting Trump accounts does not include similar language. We believe that this was an oversight. In the absence of specific language qualifying contributions to Trump accounts for the annual exclusion for gift tax and GST tax, the contributions would not qualify because they are not gifts of a present interest in property. As a result, any contribution to a Trump account will require the donor to file a federal gift tax return reporting the contribution and requiring the donor to either use a portion of his or her lifetime exemption to cover the contribution or (if the donor has no remaining lifetime exemption) pay gift tax. If the beneficiary is a skip person, the donor would also be required to use a portion of the donor's lifetime GST exemption or (if the donor has no remaining lifetime GST exemption) to pay GST tax.

If a contribution to a Trump account were to qualify for the annual exclusion for gift and GST tax purposes, a gift would not trigger a gift tax return filing requirement pursuant to section 6019(a) ("Any individual who in any calendar year makes any transfer by gift other than ... (1) a transfer which under subsection (b) or (e) of section 2503 is not to be included in the total amount of gifts for such taxable year ... shall make a return for such year with respect to the gift tax imposed by subtitle B.").

C. Solution

Language similar to that in section 529(c)(2)(A)(i) should be added to section 530A as a technical correction to provide that, for purposes of chapters 12 and 13, contributions to Trump accounts "shall be treated as a completed gift to such beneficiary which is not a future interest in property."

Alternatively, Treasury could issue guidance under section 530A providing that, for purposes of chapters 12 and 13, contributions to Trump accounts "shall be treated as a completed gift to such beneficiary which is not a future interest in property."

III. Request for Guidance Concerning the Act's Changes to Section 1202 Dealing With Qualified Small Business Stock

A. Background

Section 1202, originally enacted in 1993[5] and amended over the years,[6] provides for a partial or complete exclusion of gain from the sale of "Qualified Small Business Stock" (hereinafter, "QSBS" or "QSB stock"). In order for taxpayers to get the benefit of the exclusion under section 1202, the corporation must meet certain qualifications to be a qualified small business, most notably the "Aggregate Gross Asset Requirement" (discussed and defined below), and a shareholder must meet certain holding period requirements with respect to the stock (*e.g.*, 5-year holding period) in order for the realized gain to be eligible for exclusion ("eligible gain," defined below). The amount of exclusion afforded a taxpayer is limited by the "Per-Issuer Limitation" (discussed and defined below). Further, the percentage of exclusion (*i.e.*, 50%, 75%, or 100%) afforded to a taxpayer depends on the date the taxpayer acquired the QSB stock from the issuing corporation.

The Act amended section 1202 in a number of significant ways.[7] It changes the holding period required for realized gain on the sale of QSB stock to be considered the eligible gain from just 5 years to a three-tiered structure to include 3- and 4- year holding periods. To that end, QSB stock with shorter holding periods will have a 50% and 75% exclusion, respectively. The Act also increases: (i) the Aggregate Gross Asset Requirement from $50 million to $75 million (with inflation adjustments), and (ii) the "Per-Taxpayer Limitation" (defined and discussed later) in the Per-Issuer Limitation from $10 million to $15 million (with inflation adjustments).

B. Technical correction

1. The Act's amendment

The Act adds an inflation adjustment increase to the Aggregate Gross Asset Requirement.[8] As enacted, the Act makes this amendment to "section 1202(b)" (the subsection is titled "Per-Issuer Limitation on Taxpayer's Eligible Gain") when it should be to "section 1202(d)" (the subsection is titled "Qualified Small Business," which includes the Aggregate Gross Asset Requirement).[9] This makes the reference to "paragraphs (1)(A) and (1)(B)" in the text make sense.

2. Recommendation

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5 Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, more commonly referred to as the "Revenue Reconciliation Act of 1993."

6 *See* notably, American Recovery & Reinvestment Act of 2009, P.L. 111-5, Creating Small Business Jobs Act of 2010, P.L. 111-240, and Consolidated Appropriations Act of 2016, P.L. 114-113.

7 Section 70431 of the Act.

8 Section 70431(c)(2) of the Act makes the change to section 1(f)(d) from "calendar year 2016" to "calendar years 2025." Section 1202(d)(4)(B) (after technical correction).

9 Section 70431(c)(2) of the Act. Section 70431(c)(1) of the Act correctly provides, "IN GENERAL.—Subparagraphs (A) and (B) of section 1202(d)(1) are each amended by striking '$50,000,000' and inserting "$75,000,000'."

Congress should make a technical correction to section 70431(c)(2) of the Act so that the inflation adjustment amendment is to "Section 1202(d)." *Alternatively, Treasury should consider addressing this through published guidance.*

C. Amending eligible gain and applicable percentage

1. The Act's amendments

The Act amends section 1202(a)(1) and adds new section 1202(a)(5). Section 1202(a)(1)(B) adds the concept of an "applicable percentage" to realized gain from the sale of QSB stock "acquired" after the "applicable date" (these terms are defined below). These are defined in section 1202(a)(5), so this provision only applies to QSB stock issued after the enactment of the Act (July 4, 2025).

Section 1202(a)(5) defines the "applicable percentage" (hereinafter, "Applicable Percentage") as follows:[10]

- 50% (exclusion of gain), if stock was acquired after the "applicable date" and held for at least 3 years;
- 75% (exclusion of gain), if stock was acquired after the "applicable date" and held for at least 4 years; and
- 100% (exclusion of gain), if stock was acquired after the "applicable date" and held for at least 5 years.

The "applicable date" means the date of enactment.[11] However, the foregoing applicable percentages are effective for taxable years beginning after the date of enactment (July 4, 2025).

Section 1202(a)(6)(B) in defining the "acquisition date" provides:

> In the case of any stock which would (but for this paragraph) be treated as having been acquired before, on, or after the applicable date, whichever is applicable, the acquisition date for purposes of this section shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223.[12]

2. Problem/Recommendation

Citing section 1223 in section 1202(a)(6)(B) as the determining factor of the date of acquisition for section 1202 purposes causes a significant amount of uncertainty for purposes of determining the holding period in section 1202(a)(5) and the acquisition date for purposes of section 1202(a)(1)(B). Section 1223 has fifteen different subsections, but generally provides for tacking of holding periods. When this reference was included, its possible impact on QSBS planning may not have been known. This provision should likely provide that the

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[10] Section 1202(a)(5).

[11] Section 1202(a)(6)(A).

[12] Section 1202(a)(6)(B).

"acquisition date" should be determined without regard to section 1223 (as section 1045 does, as discussed below).

In order to be a "qualified small business" (hereinafter, "QSB") under section 1202, the issuer of the stock must be a C corporation.[13] Furthermore, QSBS must be acquired at its original issuance either in exchange for money or other property (other than stock) or as compensation for services provided to such corporation.[14] When property is transferred to a C corporation in exchange for stock in the corporation, gain or loss is generally recognized by the contributing shareholder. The notable exception to this rule is outlined in section 351, generally describing non-recognition transfers of property to a controlled corporation in exchange for stock in the controlled corporation.

Under section 1223, if property is transferred to a corporation in a section 351 transaction, a transferor's holding period for the stock received in the transaction is the same as the transferor's holding period for the property exchanged for the stock, if the property was a capital asset or section 1231 property (*e.g.*, real property and depreciable property used in a trade or business in the transferor's hands and held for more than one year).[15] The holding period for stock received for property that is not a capital asset or section 1231 property does not include the holding period of the transferred property. As a result, when a transferor transfers some property that is a capital asset or section 1231 property and other property that is not, the stock received will have a split holding period.[16] The transferee corporation's holding period for property received in a section 351 transaction includes the transferor's holding period for the property, because the corporation's basis in the property is determined by reference to the transferor's basis.[17] For these purposes, cash, accounts receivable and business assets held for less than one year generally are not subject to section 1223, whereas goodwill and similar intangible assets of a business that has been conducted more than one year generally are subject to section 1223. The holding period for self-created goodwill of a business (including name or brand value, as well as customer relationships) generally begins at the time of or shortly following the inception of the business.[18]

After its initial enactment in 1993, section 1202 was amended in 2009 and 2010 to increase the exclusion from 50 percent to 75 or 100 percent exclusions, depending on the acquisition date of the QSBS. After the 75 percent and 100 percent exclusions were enacted, each of the respective subsections were amended in 2012[19] to include the following flush language in sections 1202(a)(3) and (a)(4): "In the case of any stock which would

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13 *See* Section 1202(d)(1).

14 *See* Section 1202(c)(1)(B).

15 Section 1223(1).

16 Rev. Rul. 85-164, 1985-2 C.B. 117. *See also* Rev. Rul. 84-111, 1984-2 C.B. 88 (When multiple assets are contributed in a single transaction, the stock has a split holding period, which is determined based on the relative fair market values of the contributed assets.)

17 *See* Section 1223(2).

18 *See, e.g., Friedlaender v. Commissioner*, 26 T.C. 1005 (1956), *Girt v. Commissioner*, 20 T.C.M. 1499 (1961) (presence of recently-established customer relationships did not impact overall holding period of goodwill of business) and Reg. § 1.197-2(b)(1) (defining "goodwill" to include a business' name or reputation).

19 American Taxpayer Relief Act of 2012, P.L. 112-240, section 324(b)(1).

be described in the preceding sentence (but for this sentence), the acquisition date for purposes of this subsection shall be the first day on which such stock was held by the taxpayer determined after the application of section 1223."[20] This may have been the genesis of the language adopted in the Act for section 1202(a)(6)(B).

Section 1045 allows a taxpayer to sell QSBS and defer the recognition of gain (typically recognized gain that is not eligible for exclusion) by rolling the proceeds of the sale, tax free, into a new acquisition of QSBS issued by a different QSB, within sixty days of the sale. Under section 1045, the taxpayer must have held the QSBS for more than six months before the sale. However, the taxpayer's holding period for such stock will be determined without regard to section 1223.[21] For section 1045 rollover purposes, section 1223(13) provides, in pertinent part, "in determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 … in the nonrecognition of any part of the gain realized on the sale of other property there shall be included the period for which such other property has been held as of the date of such sale."[22] For section 351 purposes, section 1223(1) provides, "In determining the period for which the taxpayer has held property received in an exchange, there shall be included the period for which he held the property exchanged if, under this chapter, the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged, and, in the case of such exchanges the property exchanged at the time of such exchange was a capital asset as defined in section 1221 or property described in section 1231."[23] Further, section 1223(2) states, "In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person." Except for section 1223(10) relating to the holding period of property acquired upon the death of a decedent, all of the subsections in section 1223 provide for the inclusion of time prior to the tax-free exchange (or other transaction) and a relation back to prior ownership. As such, the flush language of sections 1202(a)(3) and (a)(4) (and now section 1202(a)(6)(B) added by the Act) is broad enough to say that for purposes of determining the QSBS acquisition date, section 1223 could predate the creation of the C corporation if properties are contributed under section 351 (including a conversion of a pass-through entity to a C corporation).

Thus, for example, consider a taxpayer who purchases business property which is a capital asset on January 1, 2015. On July 5, 2025, a day after the enactment of the Act, taxpayer contributes the property to a newly created C corporation in exchange for originally issued shares of the QSB corporation in a section 351 transaction. Under section 1223, the holding period of the QSB shares would be deemed to have started on January 1, 2015. In that case, the taxpayer would be deemed to immediately have a holding period of more than 10 years (satisfying the eligible gain holding period requirement) and the taxpayer's "Per-Taxpayer Limitation" (defined and discussed below) would be $10 million (not $15 million under the Act). What if the taxpayer had originally acquired the property in 1992, prior to the enactment of section 1202? What if the taxpayer had acquired several pieces of property in 2005, 2009, and 2020? There seems to be no tax policy

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[20] Sections 1202(a)(3) [flush language] and 1202(a)(4) [flush language].

[21] Section 1045(b)(4)(A).

[22] Section 1223(13).

[23] Section 1223(1).

rationale to have different "acquisitions dates" for section 1202 purposes for a QSB corporation newly created after the enactment of the Act.

Contrary to the foregoing, section 1202(i)(1) provides, in pertinent part, "In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation... such stock shall be treated as having been acquired by the taxpayer on the date of such exchange."[24] Section 1202(i) makes clear that this rule applies "For purposes of this section,"[25] namely for purposes of section 1202. Section 1202(i) was enacted with the original statute in 1993, and as mentioned above, the 75% and 100% exclusions were added in 2009 and 2010 respectively, but the flush language was added in 2012.[26] The issue is whether the flush language overrides section 1202(i), which we believe it does not, or whether the flush language applies for some purpose other than for determining the acquisition date of the QSBS.

The authors of an excellent article on QSBS[27] researched the legislative history and have rightfully concluded that the flush language in sections 1202(a)(3) and (a)(4) applies only for section 1045 rollover purposes (not for section 351 purposes). The authors point to the Senate report,[28] which focused on section 1045 rollovers, and to the Joint Committee on Taxation's report, which includes the following statement: "The provision is not intended to change the acquisition date determined under Section 1202(i)(1)(A) for certain stock exchanged for property."[29] Just as persuasively, the authors point out that if the flush language applied for property contribution purposes (section 351), it would create inconsistent results that were never intended. They write, "Interpreting the flush language to apply to property contributions could lead to inconsistent outcomes for founders and investors. For example, if a founder contributed a patent obtained before September 28, 2010 to a new corporation that is capitalized by an investor, the investor would get the 100 percent exclusion, but the founder would not."[30]

Now that eligible gain is defined in terms of QSB stock "held for at least 3 years (more than 5 years in the case of stock acquired on or before the applicable date),"[31] the reference to the "5-year holding period requirement"

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24 Section 1202(i)(1) and (1)(A).

25 Section 1202(i).

26 American Taxpayer Relief Act of 2012, P.L. 112-240, section 324(b)(1).

27 Janet Andolina and Kelsey Lemaster, *Candy Land or Sorry: Thoughts on Qualified Small Business Stock*, Tax Notes (Jan. 8, 2018), p. 205.

28 S. Rep. No. 112-208, at 67-69 (2012) (the Senate's version of the eventual bill was the Family and Business Tax Cut Certainty Act of 2012).

29 JCT, *General Explanation of Tax Legislation Enacted in the 112th Congress*, JCS-2-13 (Feb. 2013), p. 185, n. 490.

30 Janet Andolina and Kelsey Lemaster, *Candy Land or Sorry: Thoughts on Qualified Small Business Stock*, Tax Notes (Jan. 8, 2018), p. 223. *See also* Senate Finance Committee, *Summary of Provisions in The American Taxpayer Relief Act of 2012*, p. 12, "The bill also clarifies that in the case of stock acquired after February 17, 2009, and before January 1, 2014, *the date of acquisition for purposes of determining the percentage exclusion is the date the holding period for the stock begins*." [emphasis added]). The latter provision is no longer needed, because, as noted above, the 100% exclusion was made permanent in 2015.

31 Section 1202(b)(2).

in section 1202(h)(2)(C), regarding transfers of QSB stock from a partnership to a partner, should be changed to reflect the new holding periods after the enactment of the Act.

3. Recommendation

We suggest the following:

- Congress should make a technical correction to section 70431(a) of the Act that provides that the "acquisition date" definition of section 1202(a)(6)(B) shall not be determined after the application of section 1223. *Alternatively, Treasury should consider addressing this through published guidance.*

- *Treasury should provide guidance on the flush language in sections 1202(a)(3) and (a)(4) that makes it clear that the reference to section 1223 is for purposes of section 1045.*

- *Treasury should provide guidance that the acquisition date for purposes of determining a taxpayer's holding period for QSBS purposes is determined under the rule set out in section 1202(i)(1).*

- Congress should make a technical amendment to replace the parenthetical "(without regard to the 5-year holding period requirement)" in section 1202(h)(2)(C) with "(without regard to the holding period requirements set out in the definition of eligible gain in subsection (b)(2))." *Alternatively, Treasury should consider addressing this through published guidance.*

D. Per-issuer limitation and the per-taxpayer limitation

1. The Act's amendment

Section 1202 contains a Per-Issuer Limitation, which prescribes the maximum gain that can be excluded under section 1202(a) by a taxpayer in a taxable year. In defining the Per-Issuer Limitation to eligible gain, the Act adds the term "applicable dollar limit" ("Applicable Dollar Limit") to accommodate the increase of the $10 million Per-Taxpayer Limitation to $15 million for stock acquired by a taxpayer after the applicable date.[32]

The Per-Issuer Limitation is applied against "eligible gain," which is defined, as amended, as "any gain from the sale or exchange of qualified small business stock held for at least 3 years (more than 5 years in the case of stock acquired on or before the applicable date)."[33] As such, "eligible gain" has two definitional requirements: (i) gain must be from the sale of QSBS (as defined and discussed below), and (ii) the taxpayer must have held the stock for more than 5 years, if acquired on or before July 4, 2025, or more than 3 years, if acquired after July 4, 2025.

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[32] Section 1202(b)(4)(A) and (B).

[33] Section 1202(b)(2). Subsection (a) of section 1202 sets out the percentage exclusion available on the sale of stock by a taxpayer other than a corporation and mirrors, but does not reference, the definition of "eligible gain" (any gain from the sale or exchange of qualified small business stock held for more than 5 years).

As amended, section 1202(b)(1) provides, "If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from dispositions of stock issued by such corporation which may be taken into account … for the taxable year shall not exceed the greater of—"[34]

- The "applicable dollar limit" (hereinafter, "Applicable Dollar Limit") for the taxable year (the "Per-Taxpayer Limitation");[35] or

- "10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year."[36]

The Applicable Dollar Limit with respect to eligible gain from a disposition of QSB stock in a corporation is:

- If the QSB stock was acquired on or before the applicable date (July 4, 2025), "$10,000,000 reduced by the aggregate amount of eligible gain taken into account by the taxpayer … for prior taxable years and attributable to dispositions of stock issued by such corporation."[37]

- If the QSB stock was acquired after the applicable date (July 4, 2025), $15,000,000, reduced by the sum of:[38]

    - "the aggregate amount of eligible gain taken into account by the taxpayer … for prior taxable years and attributable to dispositions of stock issued by such corporation and acquired by the taxpayer before, on, or after the applicable date, plus;"[39]

    - "the aggregate amount of eligible gain taken into account by the taxpayer … for the taxable year and attributable to dispositions of stock issued by such corporation and acquired by the taxpayer on or before the applicable date."[40]

The foregoing definition of Applicable Dollar Limit takes into account that QSB corporations that existed prior to the enactment of the Act could issue QSB stock after July 4, 2025, and it seeks to ensure that taxpayers who acquired shares of QSB stock under the old rules, which are then sold, would be limited to $10 million of Per-Taxpayer Limitation. It also ensures that if QSB shares acquired after July 4, 2025 are subsequently sold, then sales of shares (in previous years and the current year) acquired under the old rules would be taken into account for purposes of the taxpayer's Per-Taxpayer Limitation of $15 million. This makes clear that taxpayers

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[34] Section 1202(b)(1).

[35] Section 1202(b)(1)(A).

[36] Section 1202(b)(1)(B).

[37] Section 1202(b)(4)(A).

[38] Section 1202(b)(4)(B).

[39] Section 1202(b)(4)(B)(i).

[40] Section 1202(b)(4)(B)(ii).

cannot "double dip" hoping to get $10 million of exclusion for the old shares and $15 million of exclusion for the new shares. For example, a taxpayer acquires QSB stock of corporation Y in 2019. After holding the stock for 5 years, the taxpayer sells a portion of the stock in 2024, realizing $3 million of eligible gain. On July 5, 2025, the taxpayer acquires more QSB stock of corporation Y. In 2029, when the taxpayer sells all of its shares of corporation Y, the Applicable Dollar Limit for the taxable year will be, ignoring the cost-of-living increase discussed below, $12 million ($15 million minus the $3 million of eligible gain from 2024).

The Per-Taxpayer Limitation for QSB stock issued after July 4, 2025 will be inflation-adjusted starting in either 2026 or 2027. The text of the Act provides the inflation adjustment applies "In the case of any taxable year beginning after 2026,"[41] but section 1202(b)(5)(A)(ii), as amended in the Act, changes the reference in section 1(f)(3) from "calendar year 2016" to "calendar year 2025."[42] In other words, as written, there will be no inflation adjustment in 2026, but starting in 2027, the inflation adjustment to the Per-Taxpayer Limitation will be increased from $15 million to a number that includes the aggregate amount of inflation adjustments for calendar years 2025 and 2026 (a 2-year inflation adjustment). The Senate Finance Committee, in its section-by-section explanation, states, "the proposal increases the per-issuer dollar cap to $15 million for post-enactment shares, indexed to inflation beginning in 2027."[43] However, there doesn't seem to be any obvious policy reason to calculate the inflation adjustment in that manner. It is equally plausible to believe either of the following is true: (i) section 1202(b)(5)(A) should read as "In the case of any taxable year beginning after 2025…;" or (ii) section 1202(b)(5)(A)(ii) should change the reference in section 1(f)(3) from "calendar year 2016" to "calendar year 2026." The former suggested language would provide a 1-year inflation adjustment calculated from the beginning of 2025 that would be effective at the beginning of 2026. The latter suggested language would provide no inflation adjustment in 2026 but would provide a 1-year inflation adjustment calculated from the beginning of 2026 that would be effective at the beginning of 2027.

This inflation adjustment will continue until the Per-Taxpayer Limitation has been exhausted. Section 1202 provides, "**No Increase Once Limit Reached**— If, for any taxable year, the eligible gain attributable to dispositions of stock issued by a corporation and acquired by the taxpayer after the applicable date exceeds the applicable dollar limit, then notwithstanding any increase under subparagraph (A) for any subsequent taxable year, the applicable dollar limit for such subsequent taxable year shall be zero."[44]

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41 Section 70431(b)(2) of the Act (emphasis added).

42 Section 70431(b)(2) of the Act (emphasis added) and section 1202(b)(5)(A)(ii).

43 Senate Finance Committee Section-By-Section Explanation, p. 27.

44 Section 1202(b)(5)(B) (emphasis added).

2. Problem

The "No Increase Once Limit Reached" provision is obviously included to ensure that if a taxpayer sells QSB stock, realizing eligible gain equal to the Applicable Dollar Limit, the taxpayer can't then claim additional exclusion (Applicable Dollar Limit) in subsequent years due to the inflation adjustment. The provision was probably included with the intention that if a taxpayer realizes $6 million of eligible gain (40% of the $15 million Additional Dollar Limit, ignoring inflation adjustments) in one year, the taxpayer's inflation adjustment should be to the remaining unused Applicable Dollar Limit the following year (inflation-adjustment based on $9 million). However, that is not what it says.

As written, the provision results in an Additional Dollar Limit of zero only if eligible gain for the year exceeds the Applicable Dollar Limit, and more importantly, the inflation adjustment provision is not clearly tied to the balance of the Additional Dollar Limit at the end of each taxable year. Rather, it reads, "In the case of any taxable year beginning after 2026, the $15,000,000 amount in paragraph (4)(B) shall be increased by..."[45] In other words, a taxpayer could realize just enough eligible gain each year, leaving a small balance of Applicable Dollar Limit (*e.g.*, $100), and claim to get the inflation-adjustment based on $15 million starting from 2026.

3. Recommendation

We suggest the following:

- Congress should make a technical correction to section 70431(b)(2) of the Act in a manner that makes clear that the inflation adjustment in 1202(b)(5)(A) provides for either: (i) no inflation adjustment in 2026, but starting in 2027, the inflation adjustment to the Per-Taxpayer Limitation will be increased from $15 million to a number that includes the aggregate amount of inflation adjustments for calendar years 2025 and 2026 (a 2-year inflation adjustment); (ii) a 1-year inflation adjustment calculated from the beginning of 2025 that would be effective at the beginning of 2026; or (iii) no inflation adjustment in 2026 but providing a 1-year inflation adjustment calculated from the beginning of 2026 that would be effective at the beginning of 2027. *Alternatively, Treasury should consider addressing this through published guidance.*

- Congress should amend section 70431(b)(2) of the Act so that section 1202(b)(5)(A) reads, (A) IN GENERAL.—In the case of any taxable year beginning after 2025, the unused applicable dollar limit determined under paragraph (4)(B) at the end of the previous taxable year shall be increased by an amount equal to—". *Alternatively, Treasury should consider addressing this through published guidance.*

- Congress should amend section 70431(b)(2) of the Act so that section 1202(b)(5)(B) makes clear that there is no inflation-adjustment to any portion of the aggregate applicable dollar limit that has been used in previous taxable years. *Alternatively, Treasury should consider addressing this through published guidance.*

[45] Section 1202(b)(5).

E. Aggregate gross asset requirement

1. The Act's amendments

The Act increases the Aggregate Gross Asset Requirement from $50 million to $75 million in defining a QSB.[46] It should be noted that the Act made this change by simply striking "$50,000,000" and inserting "$75,000,000." As such, this new requirement is not tied to QSB shares issued after the applicable date; rather, it applies to all QSB qualification shares issued after the initial enactment of section 1202 in 1993.

As amended, the provision now provides that a QSB means any domestic C corporation if:[47]

- [T]he aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993 and before the issuance did not exceed $75,000,000,[48]

- [T]he aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed $75,000,000,[49] and

- [S]uch corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.[50]

With regard to the effective date, the Act provides, "The amendments made by this subsection shall apply to stock issued after the date of the enactment of this Act."[51]

Assuming the technical correction noted above is made to the inflation adjustment to the Aggregate Gross Asset Requirement, new section 1202(d)(4) provides that the $75 million limit amount will be increased by the cost-of-living adjustment starting in 2026 or 2027, but it is not clear which and from when it should be calculated. Again, as with the inflation adjustment language for the Per-Taxpayer Limitation discussed above, the text of the Act provides the inflation adjustment applies in "the case of any taxable year beginning after 2026,"[52] but section 1202(d)(4), as corrected, changes the reference in section 1(f)(3) from "calendar year 2016" to "calendar year 2025."[53] The Senate Finance Committee, in its section-by-section explanation, states, "For stock issued after the applicable date, the corporate-level aggregate-asset ceiling is increased to $75

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46 Section 70431(c) of the Act and section 1202(d)(1) (after technical correction).

47 Section 70431(c)(1) of the Act.

48 Section 1202(d)(1)(A).

49 Section 1202(d)(1)(B).

50 Section 1202(d)(1)(C).

51 Section 70431(c)(3) of the Act.

52 Section 70431(b)(1) of the Act.

53 Section 70431(b)(2) of the Act (emphasis added) and section 1202(b)(5)(A)(ii).

million, indexed to inflation beginning in 2027."[54] The discussion points on the inflation adjustment calculation for the Per-Taxpayer Limitation as written in the Act are the same with respect to the inflation adjustment to the Aggregate Gross Asset Requirement.

2. Problem/Guidance

As written, section 1202(d)(1)(A) provides that in order for a corporation to be considered a QSB, the Aggregate Gross Assets of the corporation "at all times on or after the date of enactment" of section 1202 may not exceed $75 million. How then should we interpret a situation where prior to the enactment of the Act, a C corporation was a QSB in all other respects except it exceeded the $50 million Aggregate Gross Asset Requirement (*e.g.*, $60 million), but after the Act's enactment did not exceed the new Aggregate Gross Asset Requirement limit of $75 million? Has the foregoing corporation violated the "at all times" requirement in a manner that all future issuances of stock from the corporation will not be considered QSBS? It would seem that given the amended text of section 1202(d)(1)(A) referring back to the date of the original enactment of section 1202 in 1993, the corporation would still be considered a QSB and could issue QSB stock after July 4, 2025 under the new rules of the Act.

In the foregoing example, what if after exceeding the $50 million Aggregate Gross Asset Requirement (*e.g.*, $60 million), but prior to July 4, 2025, the corporation issued shares to an investor? What is the treatment of those shares? Under the old rules those shares would not have been considered QSBS. It would seem that since the effective date of the Act's amendments "apply to stock issued after the date of the enactment," then these shares would not be considered QSBS, notwithstanding the reference back to 1993. A contrary interpretation could be that since section 1202(d)(1)(A) refers back to the date of the original enactment of section 1202, these latter issued shares could nonetheless be considered QSBS after the enactment of the Act.

3. Recommendation

We suggest the following:

- Congress should make a technical correction to section 70431(c)(2) of the Act in a manner that makes clear that the inflation adjustment in 1202(d)(4) provides for either: (i) no inflation adjustment in 2026, but starting in 2027, the inflation adjustment to the Aggregate Gross Asset Requirement will be increased from $75 million to a number that includes the aggregate amount of inflation adjustments for calendar years 2025 and 2026 (a 2-year inflation adjustment); (ii) a 1-year inflation adjustment calculated from the beginning of 2025 that would be effective at the beginning of 2026; or (iii) no inflation adjustment in 2026 but providing a 1-year inflation adjustment calculated from the beginning of 2026 that would be effective at the beginning of 2027. *Alternatively, Treasury should consider addressing this through published guidance.*

- Congress should make a technical amendment to confirm that the $75 million Aggregate Gross Asset Requirement correctly refers back to the date of enactment and not the acquisition date of the QSB shares. As such, a corporation that might have exceeded the Aggregate Gross Asset Requirement under pre-Act rules ($50 million) will continue to be a QSB, provided that it qualifies

[54] Senate Finance Committee Section-By-Section Explanation, p. 27.

under the post-Act requirements. *Alternatively, Treasury should consider addressing this through published guidance.*

- Congress should make a technical amendment to clarify the treatment of shares acquired prior to enactment of the Act, which when issued would not have been considered QSBS because the corporation failed the Aggregate Gross Asset Requirement, but which would qualify under the post-Act definition of the Aggregate Gross Asset Requirement. *Alternatively, Treasury should consider addressing this through published guidance.*

Additional Items

IV. Request for Guidance Under Reg. § 1.6035-1(h) That Would Remove The Reporting Requirement that Is Imposed Upon Trustees Of Certain Trusts Concerning The Basis Of Certain Property Acquired From A Decedent.

ACTEC recommends that Treasury provide additional guidance under Reg. § 1.6035-1(h) to remove the reporting requirement that is imposed upon trustees of certain trusts concerning the basis of certain property acquired from a decedent.

ACTEC submitted comments on the proposed regulations under sections 1014(f) and 6035 (the "proposed regulations") on May 27, 2016.[55] We appreciate and commend Treasury's responsiveness to those comments in the final regulations that it issued last year.[56] This includes Treasury's responses to ACTEC's comments regarding the burdens resulting from the imposition of a zero basis for property in some cases, the requirement to provide statements (Schedule A) within 30 days of the filing of the estate tax return to beneficiaries regarding assets they have not yet received and might not ever receive, and the seemingly unlimited reporting requirement with regard to certain subsequent transfers of property previously reported (or required to be reported) in such a statement.

With regard to the reporting of subsequent transfers, the final regulations helpfully limit that reporting to the trustees of certain trusts. ACTEC, however, continues to have reservations about the propriety of extending the reporting requirements under section 6035 to anyone other than the "executor" specified in section 6035(a)(1) and to distributions other than "from a decedent" as specified in section 1014(a) (which is incorporated by section 1014(f)(1)). As we pointed out in our comments to the proposed regulations, the reporting requirements in the statute apply to executors. Many practitioners strongly believe that expanding those requirements to trustees who are beneficiaries and not executors exceeds the statutory authority. The concern that Treasury expressed in the preamble to the proposed regulations, that taxpayers will be advised to avoid the basis consistency rules by using an intervening trust, is not reasonable in our view.[57] Thus we believe that applying the reporting requirements to trustees who are not executors results in a burden to those trustees without providing any corresponding benefit to the government.

We do not understand the purpose to be served through a trustee's furnishing of such subsequent statements to trust beneficiaries and corresponding information returns to the IRS. We assume that, in making a distribution of an asset in kind to a trust beneficiary and in carrying out its fiduciary duties, a trustee would typically advise the beneficiary of the basis of the asset, whether the basis is determined by the receipt of the asset upon a decedent's death, the trustee's purchase of the asset, the trustee's improvements to the asset or depreciation of the asset, or any other source or combination of sources. Presumably the beneficiary is

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[55] ACTEC's comments concerning the proposed regulations under sections 1014(f) and 6035 can be found at the following link: https://www.actec.org/wp-content/uploads/2023/08/ACTEC_Final_Comments_on_1014_and_6035_Prop_Regs_05_27_16.pdf.

[56] The final regulations under sections 1014(f) and 6035 can be found at the following link: https://www.govinfo.gov/content/pkg/FR-2024-09-17/pdf/2024-20429.pdf.

[57] *See* REG-127923-15, 81 Fed. Reg. 11486, 11490 (March 4, 2016).

obligated to use that as the basis for income tax purposes regardless of the source. Nevertheless, under Reg. § 1.6035-1(h), the trustee will bear the additional burden of tracing assets subject to this reporting requirement, perhaps for a very long time and while incurring unreasonable costs to the trust, apparently for the sole purpose of ultimately providing a beneficiary with a redundant statement. The trustee must file the required information return with the IRS and is subject to penalties for failing to do so, even when the trustee provides the beneficiary with basis information for the relevant assets. The reporting requirement applies not to all assets received upon a decedent's death, but only when an estate tax return was required to be filed for estate tax purposes. Although the initial reporting is somewhat straightforward for the original executor, it adds complexity for a beneficiary-trustee who has received assets from more than one decedent's estate and now must distinguish long term among those assets. It bears repeating that this reporting obligation is only being imposed for the purpose of reporting in a special form basis information that the trustee likely would have provided to the beneficiary anyway.

Moreover, if the IRS expects to enforce this reporting of subsequent transfers, it may need some way to trace those particular assets. Thus, this requirement may have the unintended result of imposing extra burdens on the IRS as well as on taxpayers.

Although the final regulations remove the requirement for reporting subsequent transfers by individuals, individual beneficiaries will still receive such statements, for example upon a distribution of assets in kind from a trust during the administration of the trust or upon termination of the trust. The receipt of such statements with respect to some assets and not others may be confusing or even frustrating to beneficiaries.

In light of the foregoing, ACTEC recommends that Treasury provide additional guidance under Reg. § 1.6035-1(h) that removes the reporting requirement imposed upon trustees of certain trusts concerning the basis of certain property acquired from a decedent.

V. Request for Guidance Concerning Spousal Rollovers Of Qualified Retirement Plan And Ira Benefits When An Estate Or Trust Is The Beneficiary Of A Decedent's Interest And The Benefits Are Distributed To The Surviving Spouse Under The Decedent's Estate Plan.

ACTEC recommends that Treasury provide guidance concerning spousal rollovers of qualified retirement plan and IRA benefits when an estate or trust is the beneficiary of a decedent's interest and the benefits are distributed to the surviving spouse under the decedent's estate plan.

Spousal rollovers of qualified retirement plans and IRAs are allowed under sections 402(c) and 408(d). More than a hundred private letter rulings have been issued since the late 1980s allowing a spousal rollover when an estate or trust (as opposed to the surviving spouse) is named as beneficiary. In the vast majority of these rulings, the spouse as executor, trustee and/or beneficiary may unilaterally effect the rollover, and this appears to be key to the result reached. In addition, whenever surviving spouses have an unfettered right to withdraw assets from a trust (such as through a power to withdraw 5% annually or the power to withdraw the entire corpus, or the trustee is obligated to distribute and makes the asset available for the spouse to withdraw), any amount of a qualified plan or IRA withdrawable in kind should be permitted as a rollover, regardless of whether the spouse is trustee. The preamble to the final section 401(a)(9) regulations, moreover, suggests a broader approach, which would permit a surviving spouse who does not unilaterally control distributions from an IRA but who does actually receive a distribution from a decedent's IRA to complete a spousal rollover.

The basic fact pattern found in the private letter rulings arises frequently. Therefore, we believe that a published ruling is needed. Currently, after the death of a plan participant or IRA owner, the spouse may be obliged to obtain his or her own ruling at considerable cost and inconvenience, either because the plan administrator or IRA sponsor insists on a ruling or simply because the spouse knows that even numerous private letter rulings issued to others may not be relied on. Treasury's promulgation of a revenue ruling on this issue would provide assurance to plan sponsors and guidance to taxpayers concerning the circumstances under which a spousal rollover is valid if an estate or trust is named as the beneficiary. Such circumstances can include where a spouse has unilateral control over the decision to distribute the decedent's interest in the plan or account, where the spouse actually receives such a distribution, or in both such circumstances.

ACTEC previously addressed this issue at some length in its April 15, 2009 letter to Henry S. Schneiderman, Assistant Chief Counsel, Internal Revenue Service (the "2009 ACTEC letter"), and we have attached a copy of that letter as Exhibit A to this memorandum. We respectfully refer Treasury to the 2009 ACTEC letter, which provides additional details concerning the issues described here and presents a proposed resolution that would obviate the current need for private letter rulings in this context.

VI. Request for Guidance Concerning Certain Foreign Trust Issues

The following topics relating to foreign trusts require clarification or modification. We respectively request that they be included in the priority guidance plan.

1. Clarification of section 679.

Section 679(a) provides that a U.S. person who transfers property, directly or indirectly, to a foreign trust that has a U.S. beneficiary is treated as the owner of the portion of the trust attributable to the transfer. Reg. §1.679-1(c) defines a "U.S. person" by reference to section 7701(a)(30) of the Code, which includes a U.S. trust. Reg. §1.679-3(b)(1) provides that if any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust the grantor is deemed to own is treated as a transfer of property by the deemed owner (not by the trust). However, if the U.S. trust is **not** treated as owned by a U.S. person, does the same rule apply? Or does §679 apply only if the transferor trust is treated as an intermediary so that the transfer is deemed to be made "indirectly" by the U.S. person who funded the transferor trust, assuming that such person is living at the time of the transfer to the foreign trust?

Reg. §1.671-2(e)(5) provides that when a trust transfers property to another trust, the grantor of the transferor trust (and not the trust itself) generally is treated as the grantor of the transferee trust (unless the transfer is made by a beneficiary's exercise of a general power of appointment). However, section 679 does not use the term "grantor." Therefore, it is not clear whether these regulations are relevant to the interpretation of section 679.

If the transferor trust is not a grantor trust, *e.g.* because the grantor is deceased, will the U.S. trust that transfers property to the foreign trust be deemed to own the transferred property? Or should a transfer from a U.S. trust to a foreign trust be taxed as a sale under section 684? Or should the transfer be taxed the same as a distribution to a foreign beneficiary?

If the nongrantor U.S. trust that transfers property to a foreign trust is treated as the owner of the assets transferred to the foreign trust, some of the consequences could be problematic. For example, if the foreign trust's income is deemed to be income of the U.S. trust, then the foreign trust has no DNI or UNI and any tax can be collected only from the U.S. trust. The beneficiaries of the foreign trust who receive distributions are not taxable because the foreign trust has no DNI or UNI. The tax may be collected from the U.S. trust that transferred assets to the foreign trust, but that trust may lack adequate funds to pay the tax. In addition, if a U.S. beneficiary has a power of withdrawal from the foreign trust, should the beneficiary (rather than the transferor trust) be taxed on the income accruing to the foreign trust?

2. Allow determination of grantor trust status of a nonresident alien grantor to be made on a year-by-year basis consistent with the statute (section 672(f)) and Subchapter J rules.

Section 672(f) limits the circumstances in which a nonresident alien of the United States will be treated as the owner of a trust under the grantor trust rules of Subchapter J. Exceptions apply, *inter alia*, (a) if the grantor has the right to revest the trust property; or (b) if the only distributions permitted during the grantor's lifetime are to the grantor and/or the grantor's spouse. Reg. §1.672(f)-3(a)(1) provides: "A trust (or portion of a trust) that fails to qualify for the exception provided by this paragraph (a) [the grantor has the power to revest assets of the

trust] for a particular taxable year of the trust will be subject to the general rule of §1.672(f)-1 [disallowing grantor trust treatment] for that taxable year and all subsequent taxable years of the trust." The statute does not contain this limitation. Moreover, grantor trust status in every other context may change from year to year depending upon the relevant facts in the particular taxable year. There is no justification for this rule.

Section 672(f)(2)(A)(ii) allows a nonresident alien to be treated as the grantor owner of a trust if "the only amounts distributable ... during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor." Reg. §1.672(f)-3-(b)(4) Example 3 provides that if a trust allowed a distribution to a person other than the grantor or the spouse of the grantor for a limited period of time (e.g. to pay a child's law school tuition), the trust would fail to qualify as a grantor trust even after the other person's right to payments ceased (e.g. following the child's graduation from law school). Following the termination of the right of a third party to receive distributions, the trust could no longer distribute to any person other than the grantor or the spouse of the grantor during the lifetime of the grantor, and the exception thereafter should apply.

These limitations can be avoided by re-settling the trust but in some cases there would be adverse consequences to resettlement under the laws of the grantor's residence.

3. Clarification of the application of section 684(c) to trust migrations.

Section 684(c) imposes a tax on a U.S. trust which becomes a foreign nongrantor trust. Reg. §1.684-4(a) says that this rule applies *when a U.S. person funded a U.S. trust that subsequently became foreign*, which could be understood to limit the scope of the statute to U.S. trusts funded by U.S. persons. It would be helpful to clarify whether this is true and to further clarify whether the scope of the statute is limited to persons who were U.S. persons when the trust was funded and not when the migration occurred.

VII. Request For Guidance as to How the Income of A Grantor Trust With More Than One Grantor Should Be Allocated Among The Different Grantors and Whether a Grantor Trust With More Than One Grantor Can Be Severed Into Separate Trusts Each of Which Would Be Treated As Having A Separate Grantor.

Problem

Grantor trusts with multiple grantors are created with some frequency, particularly by husbands and wives who are not aware of the administrative difficulties they can cause. Questions arise as to how to allocate trust income among the different grantors and how to treat transactions between the trusts and one or more of their grantors. When the trustees of a grantor trust with multiple grantors become aware of the difficulties of dealing with their trust or when one of the grantors die, the trustees often conclude that it would be desirable to sever the trust into separate trusts that would be treated as grantor trusts with separate grantors. Unfortunately, neither a regulation nor a revenue ruling provides guidance as to whether and how such a trust could be divided into separate trusts with separate grantors.

Recommendation

We recommend that Treasury issue a regulation or that the IRS issue a revenue ruling providing that a grantor trust can be severed into separate trusts with separate grantors without income, gift, or generation-skipping transfer tax consequences and that after the severance each trust will be treated as a separate trust with a separate grantor provided that the grantors are married to each other and each grantor's portion of the trust is determined consistently with Reg. § 1.671-2(e)(6), Example (7), and 26.2654-1(b).

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VIII. The Tax Classification of Purpose Trusts, and Functionally Similar Structures, for Federal Income Tax Purposes.

We respectfully request that guidance be provided concerning the tax classification of purpose trusts, and functionally similar structures, for federal income tax purposes and set forth our recommendations as to what the guidance should provide. Our recommendations will simplify filing for taxpayers and practitioners and will reduce the administrative burden on the IRS as well.[58]

In the below comments, we recommend that Treasury provide guidance regarding purpose trusts, including:

1. Amend regulations to provide a purpose trust generally is classified for federal income tax purposes as an ordinary trust despite the fact that it has no beneficiaries.

2. Amend regulations to clarify that distributions in furtherance of the purpose of a purpose trust that are not treated as distributions to a beneficiary are not deductible as distributions under section 661 and not taxable to recipients under section 662.

3. Issue guidance on the application to purpose trusts of the grantor trust rules, transfers to foreign nongrantor trusts, and information reporting requirements.

4. Issue guidance for federal income tax purposes regarding the classification of structures organized as foundations that are functioning like purpose trusts as trusts, and entities organized as nonstock corporations that are functioning like purpose trusts as corporations. Allow purpose trusts and foundations functioning like purpose trusts to elect (such as on Form 8832, *Entity Classification Election*) to be classified as associations taxable as corporations, and entities organized as nonstock corporations to elect to be classified as ordinary trusts.

5. Provide guidance on section 4947 to clarify that it applies not only to wholly charitable nonexempt trusts, but also to wholly charitable nonexempt foundations, wholly charitable nonexempt nonstock corporations, and wholly charitable nonexempt trusts that elect to be taxable as associations taxable as corporations but in each case only if a deduction for contributions to the structure was allowed under sections 170, 545(b)(2), 642(c), 2055, 2106(a)(2) or 2522 (or corresponding provisions of prior law).

Specific Comments

Background

Treasury Regulation § 301.7701-4(a) defines an ordinary trust as an arrangement under which trustees hold title to property for the purpose of protecting or conserving it for the benefit of beneficiaries. This definition seems to require that there be "beneficiaries" in order for an arrangement to be taxable as an ordinary trust.

[58] We fully agree with the comments on this position that were set forth by the AICPA in its letter to the IRS dated April 26, 2024.

A purpose trust has no ascertainable beneficiaries. As a result, at common law,[59] purpose trusts often were held to be invalid. If there are no ascertainable beneficiaries, the validity of the trust may depend on whether another person has the ability to enforce the trust.[60]

A charitable trust may be enforced by state attorneys general. All states recognize charitable purpose trusts, some by statute. Those states that recognize noncharitable purpose trusts require that a person, such as an "enforcer" or "protector" or the court, have the ability to enforce the trustee's obligation to carry out the purposes of the trust. However, nothing in the Code or regulations defines either a charitable trust or a noncharitable purpose trust as a trust for federal income tax purposes. In fact, Reg. § 301.7701-4(a) seems to treat an arrangement as a trust only if its purpose is to vest in trustees responsibility for the protection and conservation of property for beneficiaries.

This definition is out of date because, under the laws of many states, a trust created for any lawful purpose is valid even if it has no ascertainable beneficiaries. See, for example, Section 409 of the Uniform Trust Code ("UTC"):

SECTION 409. NONCHARITABLE TRUST WITHOUT ASCERTAINABLE BENEFICIARY. Except as otherwise provided in Section 408 [dealing with trusts for the care of animals, a subset of noncharitable purpose trusts] or by another statute [some states have statutes governing other types of purpose trusts such a cemetery trusts or stewardship trusts], the following rules apply:

> (1) A trust may be created for a noncharitable purpose without a definite or definitely ascertainable beneficiary or for a noncharitable but otherwise valid purpose to be selected by the trustee. The trust may not be enforced for more than [21] years.
>
> (2) A trust authorized by this section may be enforced by a person appointed in the terms of the trust or, if no person is so appointed, by a person appointed by the court.
>
> (3) Property of a trust authorized by this section may be applied only to its intended use, except to the extent the court determines that the value of the trust property exceeds the amount required for the intended use. Except as otherwise provided in the terms of the trust, property not required for the intended use must be distributed to the settlor, if then living, otherwise to the settlor's successors in interest.

Although Reg. § 301.7701-4(a) seems to require that there be beneficiaries in order for an arrangement to be taxable as a trust, at least three authorities indicate that this may not be the view of the IRS: Rev. Rul. 58-190, 1958-1 C.B. 15 (cemetery trust), Rev. Rul. 76-486, 1976-2 C.B. 192 (pet trust), and INFO 2015-0039 (gun trust).

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[59] For a history of noncharitable purpose trusts see, Richard Ausness, "Non-Charitable Purpose Trusts – Past, Present and Future."

[60] Scott and Ascher on Trusts – Scott, Ascher and Fratcher, 6th edition, 2023 Cum. Supp. §12.10. In the case of a noncharitable purpose trust whose purpose was sufficiently clear and not unlawful or frivolous, sometimes courts would recognize the noncharitable purpose trust as an honorary trust – one in which the trustee had the right but not the duty to carry out the purposes of the trust. However, because the estate of the settlor had a reversion, in practical effect, there was a beneficiary who could enforce the reversionary interest.

In INFO 2015-0039, the IRS stated:

> The fact that a person is not identified in the trust agreement as a beneficiary does not necessarily mean that a person is not a beneficiary for either property law or federal tax purposes. *** Even if we did not consider the…Trust as having beneficiaries within the meaning of § 643, we would likely still classify it as a trust under § 301.7701-4 under the principles applied in the two revenue rulings. In each of Rev. Rul. 58-190, 1958-1 C.B. 15 and Rev. Rul. 76-486, 1976-1 C.B. 192, the Service considered the income tax consequences of nongrantor purpose trust without beneficiaries. *** The rulings hold that, even though the trusts lacked beneficiaries, if the trusts were valid under state law, they would still be recognized as trusts for federal tax purposes and thus taxable under § 641.

If this is the position of the IRS, Treasury and IRS should amend the regulation to provide clearer guidance regarding the proper classification of purpose trusts.

In addition, because the purposes of a purpose trust might be carried out through alternative structures, such as foundations (authorized in New Hampshire and Wyoming[61] as well as under foreign law) or nonstock corporations (*e.g.*, 8 Del. C. 1953 § 101 *et seq.*), guidance is needed regarding the tax classification of these alternative structures. In IRS Chief Counsel Attorney Memo AM 2009-012, the IRS stated that a foreign civil law foundation will be treated and taxed as a trust unless, based on the facts and circumstances, it is more properly classified as a business entity due to its commercial activities. See also, *Rost v. Commissioner*, 44 F.4th 294 (5th Cir. 2022) and *Estate of Swan v. Commissioner*, 247.F.2d 144 (2d Cir. 1957) both of which treated foreign foundations as trusts.

Below are some examples of purpose served by noncharitable purpose trusts:

- Stewardship of a business to avoid sale, protect interests of "stakeholders" – employees, customers, suppliers and the community,
- Ownership of a family office to provide continuity,
- Preservation of a family vacation property,
- Maintenance of a collection such as automobiles, guns, manuscripts or memorabilia,
- Promotion of a cause that may not be within the definition of "charitable" such as promoting investigative journalism, promotion of sports or games, maintaining a community park, continuing festivals, maintaining genealogy records,
- Maintenance of gravesites,
- Publication of manuscripts that were unpublished at the author's death,

[61] Wyoming Revised Statute 17-30-101 et. seq., New Hampshire RSA 564-F (2017).

- Preservation of wealth for persons using cryogenics, or

- Ownership of assets off-balance sheet of a business enterprise in order to maintain independence from management or avoid ownership restrictions on the business enterprise.

The use of noncharitable purpose trusts has received increased attention due to perceived growth in their use. For example, in 2022 a purpose trust acquired all of the voting stock, representing 2% of the equity, of Patagonia,[62] a $3 billion company. Meta recently set up a purpose trust to oversee its media content oversight board.[63] Organically Grown Company is one example of a U.S. business now owned by a purpose trust.[64] Although the use of purpose trusts to own companies is a relatively recent phenomenon in the United States, over 100 large European companies use similar structures,[65] including well-known companies, such as Bosch[66] and Ikea.[67] The Purpose Foundation has been organized to promote the use of "purpose" structures to own businesses.[68] It is timely that tax authorities provide clear guidance regarding the tax implications of this new development.

In addition, we note that section 4947 extends the private foundation rules to certain wholly charitable nonexempt trusts. Section 4947 clearly should have no application to noncharitable purpose trusts. However, currently, section 4947 treatment and guidance may not be applicable to wholly charitable entities organized as foundations or nonstock corporations that have not filed for recognition of tax-exempt status as charities.

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62 https://www.patagoniaworks.com/press/2022/9/14/patagonias-next-chapter-earth-is-now-our-only-shareholder

63 https://about.fb.com/wp-content/uploads/2019/09/oversight_board_charter.pdf and https://www.oversightboard.com/governance/

64 https://www.organicgrown.com

65 https://purpose-economy.org/en/whats-steward-ownership/

66 https://www.bosch.us/our-company/bosch-group-worldwide/

67 https://www.ingka.com/this-is-ingka-group/how-we-are-organised/

68 https://www.purpose-us.com

Recommendations

We recommend that Treasury provide guidance regarding purpose trusts, including:

1. **Amend regulations to provide a purpose trust generally is classified for federal income tax purposes as an ordinary trust.**

   We recommend that Treasury amend regulations to provide that a purpose trust that is not described in Reg. § 301.7701-4(b)-(e) or whose tax classification is not otherwise controlled by statute is classified for federal income tax purposes as an ordinary trust.

2. **Amend regulations to clarify distributions in furtherance of the purpose of a purpose trust that are not treated as distributions to a beneficiary are not deductible as distributions under section 661 and not taxable to recipients under section 662.**

   We recommend clarification of the application of sections 661 and 662 to payments in furtherance of a trust's purpose (as distinguished from payments to a beneficiary of a purpose trust). Consistent with Rev. Rul. 76-486 (holding that a pet trust is a valid trust even though it has no "beneficiaries" and no deduction is allowed for distributions for the care of the pet because a pet is not a person), we recommend that Treasury and IRS amend regulations under section 661 to clarify that distributions in furtherance of the purpose of a purpose trust that are not properly treated as distributions to a beneficiary are not deductible as distributions under section 661 (although they may be deductible under section 642(c) if made for charitable purposes) and not taxable to the recipients under section 662.

3. **Issue guidance on the application to purpose trusts of the grantor trust rules, transfers to foreign nongrantor trusts, and information reporting requirements.**

   Further, we recommend that Treasury and IRS issue guidance for federal income tax purposes concerning the application to purpose trusts of Subpart E of Subchapter J (the grantor trust rules, and particularly section 679), section 684 (transfers to foreign nongrantor trusts), and section 6048 and other information reporting requirements. Treasury and IRS should also provide clarification that the grantor trust rules apply.

4. **Issue guidance for federal income tax purposes regarding the classification of structures organized as foundations that are functioning like purpose trusts as trusts, and entities organized as nonstock corporations that are functioning like purpose trusts as corporations. Allow purpose trusts and foundations functioning like purpose trusts to elect (such as on Form 8832) to be classified as associations taxable as corporations, and entities organized as nonstock corporations to elect to be classified as ordinary trusts.**

   Specifically, we recommend that Treasury issue guidance classifying for federal income tax purposes:

   (A) Structures organized as foundations that are functioning like purpose trusts as trusts; and

   (B) Entities organized as nonstock corporations that are functioning like purpose trusts as corporations.

   We also recommend that Treasury issue guidance allowing for federal income tax purposes:

(A) Purpose trusts and foundations that are functioning like purpose trusts to elect to be classified as associations taxable as corporations (and the grantor trust rules would not apply); and

(B) Entities organized as nonstock corporations that are functioning like purpose trusts to elect to be classified as ordinary trusts.

Treasury should adopt this recommendation and amend Reg. § 301.7701-4(a) to provide that structures that are validly organized as purpose trusts under applicable property law are taxable as "ordinary trusts" under Reg. § 301.7701-4(a), unless the trust is a business trust as defined in Reg. § 301.7701-4(b), a fixed investment trust as defined in Reg.§ 301.7701-4(c), a liquidating trust as defined in Reg. § 301.7701-4(d), or an environmental remediation trust defined in Reg. § 301.7701-4(e). A "purpose trust" is a trust organized for a purpose – which may be charitable or noncharitable and may or may not be economic – that does not have at least one ascertainable beneficiary who has standing to enforce the fiduciary obligations of the trustee.

Similarly, we also recommend that a structure organized as a foundation under applicable property law that is functioning in the same manner as a purpose trust also should be classified and taxed as an ordinary trust.

However, structures created for similar purposes and organized as nonstock corporations should be taxable as corporations in accordance with Reg. § 301.7701-2(b)(1).

While we recommend that, as the default treatment (unless there is an election otherwise), a purpose trust and a functionally similar foundation should be classified as a trust, and a nonstock corporation should be taxable as a corporation, we suggest Treasury allow taxpayers to elect whether a trust, or a foundation, or a corporation functioning as a purpose trust will be taxed as a trust or as an association taxable as a corporation.

5. **Provide guidance on section 4947 to clarify that it applies not only to wholly charitable nonexempt trusts, but also to wholly charitable nonexempt foundations, wholly charitable nonexempt nonstock corporations, and wholly charitable nonexempt trusts that elect to be taxable as associations taxable as corporations but in each case only if a deduction for the structure was allowed under sections 170, 545(b)(2), 642(c), 2055, 2106(a)(2) or 2522 (or corresponding provisions of prior law).**

Treasury should provide guidance regarding section 4947 to clarify that in addition to applying to wholly charitable nonexempt trusts, it also applies to alternative structures, such as wholly charitable nonexempt foundations and wholly charitable nonexempt nonstock corporations, as well as to nonexempt charitable trusts that elect to be taxable as associations taxable as corporations.

Discussion

The absence of guidance on the tax classification of purpose trusts makes compliance difficult. Taxpayers and their advisors need clarification of the fundamental question as to what rules apply and what forms are required to be filed.

The growth in the use of noncharitable purpose trusts makes this issue important. If a purpose trust is not treated as a trust, the existing regulations offer no guidance as to how it should be classified. Under Reg. § 301.7701-3, it would be treated as an eligible entity with the right to elect to be classified as an association taxable as a corporation, or as a partnership, and if it has only one member, as a disregarded entity. Since a purpose trust has no members, if it were classified as a disregarded entity or as a partnership there would be no members or partners to pay the tax on the trust's income.

Treating purpose trusts as trusts appears to be consistent with prior IRS guidance on this issue. Similarly, treating foundations functioning like trusts as trusts is consistent with prior IRS guidance.

Reg. § 301.7701-2(b)(1) states that all corporations organized under state or federal corporation laws or under a statute of a federally recognized Indian tribe are classified as corporations for tax purposes. Nothing in the regulation creates an exception for nonstock corporations.

Although the election in our recommendations would expand the definition of "business entities" that are eligible to make tax classification elections under Reg. § 301.7701-3(a) to include trusts (because currently trusts are not included as "business entities" under Reg. § 301.7701-2), in practical effect, it is not a meaningful expansion of election rights because an entity can effectively elect its tax classification by choice of the law under which it is organized. We think allowing a purpose trust, or an alternative structure functioning as a purpose trust, to elect its tax classification is a reasonable expansion of the election allowed in Reg. § 301.7701-3 for business entities because a de facto election is possible by appropriately choosing to organize as a trust, foundation, or corporation under state law.

IX. Request for Guidance under Section 2036

We respectfully request that guidance under section 2036 be provided concerning the following:

1. Reg. § 20.2036-1(c) provides that payments from transferred property that are to be made to a decedent after his or her death are not to be included in his or her gross estate under section 2033 when the transferred property is included under section 2036 because "they are properly reflected in the value of the trust corpus included under [section 2036]." This regulation is intended to prevent the double inclusion of property under both section 2036 and section 2033. Yet, despite this provision, the IRS successfully argued in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), that a decedent who transferred property to a company over which he retained control must include in his gross estate, under section 2036, all of the transferred property plus the value of his retained interest in the company. Reg. Sec. 20.2036-1(c) should be clarified to prevent all double taxation of transferred property.

2. Reg. §20.2038-1(a)(2) provides that no inclusion is required under section 2038 for a power over transferred property that can be exercised only with the consent of all parties having an interest . . . in the transferred property if the power adds nothing to the rights of the parties under local law. This provision reflects the Supreme Court's decision in *Helvering v. Helmholz*, 296 U.S. 93 (1935) and should be added to the regulations under section 2036.

3. The provision in Reg. Sec. 20.2036-1(b)(3) that provides that a decedent is deemed to have retained a power over transferred property even if the ability to exercise the power is subject to a contingency beyond the decedent's control is not based on the best reading of the underlying statutory authority. *Estate of Farrel v. United States*, 553 F.2d 637 (Ct. Claims 1977), which upheld this regulation, relied on the deference due to Treasury Regulations, that the current Supreme Court weakened in *Loper Bright Enterprises v. Raimundo*, 603 U.S. 369 (2024).

X. Request for Guidance on the Regulations Under Section 2701 That Seem to Impermissibly Expand the Scope of the Section

This portion of our recommendations responds to the request for recommendations that relate to regulations potentially described in Section 2(a) of Executive Order 14219 (90 FR 10583), specifically those regulations that are based on anything other than the best reading of the underlying statutory authority or prohibition.

1. Statutory Overview

Section 2701 provides that the value of certain retained interests in a corporation or partnership is disregarded in determining whether a transfer of an interest in the corporation or partnership to a member of the transferor's family is a gift and for purposes of valuing any such gift.[69] By its terms, section 2701 may apply in the event of a transfer of an interest in a corporation or a partnership by an individual to her spouse, a lineal descendant of the transferor or her spouse, or the spouse of any such descendant if the transferor, her spouse, an ancestor of the transferor or the transferor's spouse, or the spouse of any such ancestor retains a senior distribution right in the entity (provided certain family members of the transferor control the entity) or a liquidation, put, call, or conversion right with respect to the entity.

Section 2701 specifies attribution rules for determining whether an individual holds an interest in an entity, attributing to an individual any interest held indirectly by such individual through a corporation, partnership, trust, or other entity.[70] It further provides that certain transactions – specifically, a contribution to capital or a redemption, recapitalization, or other change in the capital structure of a corporation or partnership – constitute transfers to which Section 2701 may apply.[71]

2. Impermissible Expansion of the Statutory Rules

The rules regarding attribution and deemed transfers as set forth in the Treasury Regulations promulgated under section 2701 do not reflect the best reading of section 2701 and extend its scope beyond the statutory rules.

a. Attribution Rules

In the case of equity interests held by an estate or trust, section 2701 attributes the interests to an individual only if the equity interests are "held indirectly" by the individual through the estate or trust.[72] This statutory provision plainly suggests that property held by an estate or trust is attributable to an individual only in limited instances where the individual has a present interest in the property (for example, if the property is specifically bequeathed to an individual or, in the case of a trust, the individual has the right to withdraw the property) or where a grantor funds a trust which is includible in the grantor's estate). However, the attribution rules in the Treasury Regulations exceed this simple reading in several respects.

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69 Section 2701(a)(1).

70 Section 2701(e)(3).

71 Section 2701(e)(5).

72 Section 2701(e)(3).

First, if an individual has a beneficial interest in an estate or trust and the individual's beneficial interest may, in the discretion of a fiduciary, be satisfied by an equity interest in a corporation or partnership, the individual beneficiary is deemed to own a portion of the equity interest, assuming the maximum exercise of discretion in favor of the beneficiary.[73] This is so even though the individual may never be entitled to receive a distribution of the underlying equity interest.

Second, if a trust owns an equity interest and an individual is treated as the owner of the trust under subpart E, part 1, subchapter J of the Code, the trust's equity interest is attributed to the deemed owner of the trust property for income tax purposes.[74] This provision conflates ownership for income tax purposes with ownership for property law purposes. Indeed, in many cases, an individual treated as the owner of a trust for income tax purposes has no right to receive or acquire any portion of the trust property at any time.

b. <u>Ordering Rules</u>

Because the attribution rules under the Treasury Regulation result in attribution beyond instances where an estate or trust merely holds an interest on behalf of an individual, they may result in a particular equity interest being attributed to more than one individual. Therefore, Reg. § 25.2701-6 includes ordering rules for determining how an interest attributed to multiple individuals should be allocated. The ordering rules first attribute senior equity interests – that is, interests which would implicate section 2701 if retained by the transferor, her spouse, or certain ancestors – to the transferor and such family members before they may be attributed to other individuals.[75] The rules invert the ordering assumption with respect to junior equity interests, first attributing them to the transferee in a particular transfer.[76] By doing so, the Treasury Regulation attributes equity interests to individuals in the most adverse manner possible for the transferor.

Further, the ordering rules suggest that a transfer by an individual of a pro rata portion of all of his or her interests in a corporation or partnership to a grantor trust (for income tax purposes) for the benefit of his or her descendants itself triggers the application of section 2701. This is so because, under section 2701, the transferor is treated as the owner of any senior equity interests transferred to the grantor trust, while the beneficiaries – in this case, the transferor's descendants – are treated as receiving the junior interests. Accordingly, this rule undermines the exception to the application of section 2701 in the case of a transfer which proportionally reduces each class of equity interest held by the transferor and certain applicable family members, commonly known as the vertical slice exception.[77]

The ordering rules under the Treasury Regulation, which are required only due to the Treasury Regulation's expansive attribution rules, thereby may result in the application of section 2701 to instances where it otherwise would not apply by its terms or by the terms of exceptions provided under applicable regulations.

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73 Reg. § 25.2701-6(a)(4).

74 Reg.§ 25.2701-6(a)(4)(ii)(C).

75 Reg.§ 25.2701-6(a)(5)(i).

76 Reg.§ 25.2701-6(a)(5)(i)(ii).

77 Reg.§ 25.2701-1(c)(4).

c. Deemed Transfers

The expansive attribution rules also result in additional deemed transfers which may implicate Section 2701. Because the Treasury Regulations attribute interests held in a grantor trust to the deemed owner of the trust for income tax purposes, the Treasury Regulation includes a corollary provision treating the termination of grantor trust status as a transfer which may implicate Section 2701.[78] This provision may result in the application of Section 2701 even where an individual's beneficial interest in the underlying entity remains unchanged. This outcome differs significantly from what would constitute a deemed transfer under the statute, which limits deemed transfers to capital transactions involving a corporation or partnership which would shift beneficial interests among the owners of the entity.[79]

3. Conclusion

Reg. §§ 25.2701-1(b)(2)(C)(1), 25.2701-6(a)(4), and 25.2701-6(a)(5) do not reflect the best reading of Section 2701 and extend the scope of the statute insofar as they would result in (i) the attribution of an equity interest held by an estate trust to an individual, except in instances where the individual has a present interest in the property or, in the case of an individual who settles a trust, where the trust is includible in her estate, (ii) the attribution of an equity interest held by an estate or trust being attributed to more than one individual, (iii) the attribution of an equity interest held by a grantor trust to its deemed owner for income tax purposes, or (iv) the termination of a trust's grantor trust status being treated as a transfer for purposes of section 2701. Accordingly, we recommend that Treasury amend Reg. § 25.2701-6(a)(4) to limit the attribution of equity interests held by an estate or trust to individuals holding a present interest in the underlying property or, in the case of a trust, to the settlor of the trust in the event the trust is includible in the settlor's estate. We further recommend that Reg. § 25.2701-6(a)(4) be amended to attribute to any individual holding a present interest in a trust a pro rata share of all interests in a corporation or partnership held by such trust and revoke Reg. § 25.2701-6(a)(5). Finally, we recommend that Treasury revoke Reg. § 25.2701-1(b)(2)(C)(1).

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[78] Reg.§ 25.2701-1(b)(2)(C)(1).

[79] Section 2701(e)(5).

XI. Request for Guidance under on the Regulations Under Section 2702 That Seem to Impermissibly Expand the Scope of the Section as They Relate To Grantor Retained Annuity Trust (GRATS), Personal Residence Trusts And Qualified Personal Residence Trusts

This portion of our suggestions also responds to the request for recommendations that relate to regulations potentially described in Section 2(a) of Executive Order 14219 (90 FR 10583), specifically those regulations that are based on anything other than the best reading of the underlying statutory authority or prohibition.

We recommend that Treasury revise the regulations promulgated under section 2702 dealing with retained qualified interest and retained interests in residence trusts and qualified residence trusts that are inconsistent with the best reading of the section and that create unnecessary burdens and uncertainty for taxpayers who transfer interests in trusts to family members. Those regulations that we believe should be revised are identified and discussed below.

1. Qualified Interests

Section 2702(a) provides that a transferor who transfers an interest in trust to or for the benefit of a family member and retains an interest in that trust will be treated for gift tax purposes (subject to certain exceptions) as having retained an interest with a zero value unless the retained interest in is the form of a qualified interest. Section 2702(b) provides its own definition of qualified interest. A qualified interest is:

> (1) any interest which consists of the right to receive fixed amounts payable not less frequently than annually,
>
> (2) any interest which consists of the right to receive amounts which are payable not less frequently than annually and are a fixed percentage of the fair market value of the property in the trust (determined annually), and
>
> (3) any noncontingent remainder interest if all of the other interests in the trust consist of interests described in paragraph (1) or (2).

Qualified interests are excepted from the zero valuation rule because Congress determined that they were easily valued.[80] Unlike the express delegation authority given to Treasury in section 2704, which was enacted at the same time as section 2702, nothing in section 2702 delegates to Treasury the authority to add any additional requirements to the statute's simple definition. Nor is there any ambiguity in the statutory definition that would justify any additional requirements.

The legislative history of section 2702 makes it clear that Congress intended that retained interests that "take an easily valued form – as an annuity or unitrust interest" would not be subject to the zero valuation rule.[81] The right to receive a fixed amounts payable not less frequently than annually is an easily valued right. Section 2702 provides that the value of any qualified interest is to be determined under section 7520. Section 7520 provides that the value of any annuity is to be determined under tables prescribed by Treasury using an interest

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[80] 136 Cong Rec. 30,485, 30538.

[81] 136 Cong Rec. 30,485, 30538.

rate equal to 120% of the federal midterm rate in effect under section 1274 for the month in which the value of the retained interest is determined (the "section 7520 rate"). The regulations described below add additional requirements that make no meaningful contribution to the Congressional objective of imposing the zero valuation rule of section 2702(a) on difficult to value retained interests and are, therefore, inconsistent with the best reading of the statute.

a. Prohibition Against Use of Withdrawal Rights. Reg. §25.2702-3(b)(1)(i) provides that the right to receive a fixed amount does not include a right of withdrawal of a fixed amount despite the fact that the present value of both types of rights would be easily determined under section 7520 by this formula:

$$\text{Annual Amount} \times \frac{1-(1+r)^{-n}}{r}$$

In this formula "r" equals the section 7520 rate and "n" equals the number of years that the right exists. The fact that the taxpayer might fail to exercise a withdrawal right would not compromise the objective of section 2702. The failure would be treated for gift tax purposes as an additional taxable gift to the trust if the right lapsed and until the right lapsed, as a below market rate loan to the trust under section 7872.

b. Prohibition Against Use of Notes to Satisfy Payment Obligations. Reg. §25.2702-3(b)(1)(i) and (d)(6), which was added to the regulations more than seven years after the final regulations under section 2702 were adopted, requires that the governing instrument of the trust prohibit the issuance of a note, other debt instrument, option, or other similar financial arrangement to satisfy the right to receive a fixed amount. Treasury justified this prohibition in the preamble to the proposed regulations by stating that:

> Delaying payment by the use of a note to satisfy the annual payment obligation alters the true value of the transferor's retained interest, contrary to Congressional intent in requiring provisions ensuring an accurate valuation of the interest.[82]

This statement in the preamble is inconsistent with the reality of the financial markets. Accepting a note in payment of a payment obligation does not alter the true value of the transferor's retained interest if the debt instrument has a value equal to the amount of the payment obligation. A debt instrument, like many other forms of property, has a value that is easily determinable based on factors such as the credit worthiness of the obligor and the interest rate. If a note issued by a trust in satisfaction of an annuity right has a value equal to the amount of the annuity, there is no basis in the statute or its legislative history for prohibiting its use to satisfy the annuity obligation. If there is a concern that the trust might fail to make the payments required under the debt instrument, the regulations could remind the reader that failure to enforce the terms of a debt instrument would likely result in a taxable gift.

c. Treatment of Amounts That Exceed Amounts Payable in the Immediately Preceding Year by More Than 120%. Reg. §25.2702-3(b)(ii)(A) limits the value of the right to receive fixed amounts to the extent that the payments in one year exceed the payments in the previous year by more than 120% despite the fact

[82] Notice of Proposed Rule Making – Definition of a Qualified Interest in a Grantor Retained Annuity Trust and a Grantor Retained Unitrust, 64 Fed. Reg. Vol. 64, 3325 (June 22, 1999).

that the present value of increasing amounts can be easily determined under section 2702 no matter how great the annual percentage growth rate by using this formula:

$$\frac{pmt}{r-g}\left(l-\left(\frac{l+g}{l+r}\right)^{n}\right)$$

In this formula, "pmt" equals the initial amount, "r" equals the section 7520 rate, "n" equals the number of years over which payments are to be made, and "g" equals the rate of annual increase.

It is similarly easy to determine the present value of any stream of different annual payments by simply dividing each payment by this formula:

$$(1\text{-}r)^{n}$$

In this formula, "r" has the same meaning as in the previous formula and "n" equals the number of years between the date of the transfer to the trust and the year at the end of which the payment is to be made.

The legislative history of section 2702 suggests that Congress intended Treasury to draw upon the rules that govern the valuation of split interests in property for purposes of the charitable deduction.[83] No similar limitation exists in the regulations that define a guaranteed annuity for purposes of the gift tax charitable deduction under section 2522.[84]

d. Prohibition Against Additional Contributions.. Reg. §25.2702-3(b)(5) requires that the governing instrument of the trust prohibit additional contributions to the trust. The possibility that the taxpayer or another person might make additional contributions to the trust after the initial contribution with respect to which the qualified interest was retained cannot possibly have a negative impact on the value of the taxpayer's retained interest in the trust at the time of the initial contribution. It can only enhance the value of that interest.

Treasury and the Service justified this prohibition in the preamble to the final regulations issued under section 2702 on February 4, 1992 by pointing out that "without this prohibition, additional contributions would arguably pass to the remainder beneficiary under certain circumstances without appropriate transfer taxes being paid."[85] This concern is without basis. Any additional contribution would either enhance the value of the taxpayer's retained interest in the trust, if, for example, the value of the trust property was no longer sufficient to make the required payments, or would be treated as an additional taxable gift.

1. Limitations Imposed on the Duration of the Trust. Treas. Reg. §25.2702-3(d)(4) requires the governing instrument of the trust to fix the term of the annuity payment for a term of years, for the life of the holder of the annuity interest, or for the shorter of the two. It prohibits a term measured by the longer of the life of annuity holder and a term of years. It is no more difficult to determine the value of an annuity payable for

[83] 136 Cong Rec. 30,485, 30538.

[84] Reg. §25.2522(c)-3(c)(2)(vi).

[85] T.D. 8395 (Feb. 4,1992).

the longer of a term of years and the life of an individual, or the shorter of a term of years and the life of an individual.

2. Prohibition Against Commutation. Treas. Reg. §25.2702-3(d)(5) requires the governing instrument of the trust to prohibit commutation (prepayment) of the interest of the term holder despite the fact that the statute simply states that interest must be payable at least annually. This provision in the statute suggests that payment cannot be deferred but says nothing about prepayment. The fact that the trustee of a trust required to make the annual payments to the taxpayer may decide to prepay those amounts would not cause the value of those future payments to have a lower value at the time of the taxpayer's transfer. If the amount of the prepayment at the time the prepayment was less than the value of the remaining payments, the taxpayer would have made an additional taxable gift.

Treasury and the Service justified this prohibition in the preamble to the final regulations issued under section 2702 on February 4, 1992 by pointing out that "[c]ommutation (i.e., the prepayment of the term holder's interest) shifts the risk of a decline in interest rates from the remainder beneficiaries to the term holder.[86] The concern here seems to be that if the section 7520 rate increased after the taxpayer's initial transfer to the trust, the trustee could prepay the taxpayer's interest with an amount that was less than the present value of the remaining amounts if determined using the initial 7520 rate. To the extent that this is a legitimate concern, the regulation could have simply required that any prepayment amount be calculated using the initial section 7520 rate or the current section 7520 rate, whichever is lower.

Personal Residence Trusts

Section 2702(a)(3)(A)(ii) provides that section 2702 does not apply to a transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in the trust. Despite the fact that the statutory exception says nothing about future additions to the trust or the possible future sale of the personal residence, Treasury and the Service read the exception narrowly and concluded that it would not apply to a trust that could hold even minimal amounts of cash or to a trust that could sell the residence and reinvest the sale proceeds in other assets. Because they recognized that a trust subject to such restrictions would have limited application, they decided to provide a safe harbor for trusts that could receive cash to provide for expenses and could sell the residence and reinvest the proceeds. Section 2702(a)(3)(A)(iii) gives Treasury and the Service the right to provide in regulations that section 2702 shall not apply to transfers they determine are not inconsistent with the purposes of section 2702. As a result, the regulations now define two types of personal residence trusts, one that can never hold anything other than a personal residence with a narrow exception for cash proceeds payable as a result of damage, destruction or involuntary conversion, and one that permits additional assets and the sale of the property under certain narrow exceptions. The first type of trust is referred to as a "personal residence trust" and the second, as a "qualified personal residence trust."

[86] T.D. 8395 (Feb. 4,1992).

The regulations described below add additional requirements that make no meaningful contribution to the Congressional objective of providing an exception for the transfer of personal residences to trusts and seem inconsistent with the best reading of the statute.

1. Prohibition Against the Taxpayer Holding Interests in More Than Two Trusts That Are Personal Residence Trusts or Qualified Personal Residence Trusts. Treas. Reg. §25.2702-5(a) provides that a trust is a personal residence trust or a qualified personal residence trust only if the term holder, at the time of the transfer to the trust does not hold term interests in two other trusts that are either personal residence trusts or qualified personal residence trusts. Nothing in the statute suggests that Congress intended this limitation.

   Treasury and the Service justified this prohibition by stating in the preamble to the final section 2702 regulations issued on February 4, 1992 their belief that, because the transfer of a personal residence in trust "presents the same opportunity for valuation abuse that Congress sought to prevent by enactment of section 2702" Congress intended that the section be a narrow one "to enable transferors to pass the family home . . . or a vacation home, to younger members of the family."[87] They then looked to section 163(h) of the Code, which defines a "qualified residence" for purposes of the rule allowing the deduction of certain interest payments as the principal residence of the taxpayer and one other residence used by the taxpayer as a residence, and concluded that that section contains the most recent evidence of what Congress means when it refers to a personal residence of a taxpayer. But the existence of the precise definition of a qualified personal residence for purposes of the interest deduction simply means that Congress knows how to impose limitations on a term when it intends to do so. The fact that no such limitations appear in section 2702(a)(3)(A)(ii) suggests that it had no intention to impose any such limitations.

2. Prohibition Against Sale of the Residence to the Transferor or the Transferor's Spouse. Treas. Reg. §25.2702-5(b) and (c)(9) require that the governing instrument of a personal residence trust or a qualified personal residence trust must prohibit the sale of the residence to the transferor or the transferor's spouse either during the term of the trust or thereafter while the residence is held in a trust that is treated as owned by the transferor under section 671. This prohibition was not added to the regulations until 1997 and has no basis either in the statute or its legislative history.

   Treasury and the Service justified this prohibition in the preamble to the proposed regulations by once again opining that Congress's intention in creating the personal residence trust exception was to "enable transferors to pass the family home to younger members of the family."[88] It then concluded that permitting a sale of the residence to the transferor or the transferor's spouse was inconsistent with this intention. But nothing in the statute suggests that a sale of the residence once it has been transferred to the trust should be prohibited. The fact that Treasury and the Service limited the sale prohibition to sales to the transferor and the transferor's spouse and permits sales to others suggests that the real purpose of the regulation was to limit sales of the residence to those transactions that

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87 T.D. 8395 (Feb. 4,1992).

88 Notice of Proposed Rule Making - Sale of Residence From Qualified Personal Residence Trust, 61 Fed. Reg. 16623 (April 16, 1996).

would be recognition events for income tax purposes, a purpose that has nothing to do with Congress's purpose in enacting section 2702.

3. Prohibition Against Commutation. Treas. Reg. §25.2702-5(c)(6) requires the governing instrument of a qualified personal residence trust, but not a personal residence trust, to prohibit commutation (prepayment) of the interest of the term holder, Nothing in the statute or the legislative history justifies requiring this prohibition.

Exhibit A

ACTEC letter to Henry S. Schneiderman, Assistant Chief Counsel, Internal Revenue Service, dated April 15, 2009

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April 15, 2009

Via Hand Delivery

Henry S. Schneiderman
Assistant Chief Counsel (field Service)
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2008-47)
Room 5203
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Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2008-47: Request for Revenue Ruling Regarding Spousal Rollovers – IRC Sections 402(c) and 408(d)(3)

Dear Mr. Schneiderman:

I am writing on behalf of The American College of Trust and Estate Counsel (ACTEC), a professional association of more than 2,500 lawyers skilled and experienced in estate planning and administration and dedicated to the improvement of the law as it affects estate planning and administration.

We request that the Internal Revenue Service (IRS) issue a Revenue Ruling or similar pronouncement upon which all taxpayers may rely dealing with spousal rollovers of qualified retirement plan accounts and IRAs. The issuance of such a ruling would be in the public interest.

Background:

The qualified retirement plan and individual retirement account (IRA) have become some of the most significant assets in a person's estate. The income tax treatment of these assets affects a very large number of taxpayers. One of the most important federal income tax provisions relating to these assets involves the IRA "spousal rollover" provided for under Internal Revenue Code (Code) sections 402(c) and 408(d)(3)(A).

Under these provisions, eligible distributions from a qualified retirement plan or IRA that are paid into an IRA for the benefit of the surviving spouse of the qualified retirement plan participant or IRA owner within sixty days of the distribution date (a "spousal rollover") are not subject to inclusion in gross income under Code section 72. Such spousal rollovers are very important, because they allow the surviving spouse to take distributions over his or her own life expectancy, redetermined annually using the Uniform Table, and also to name his or her own beneficiary, who in turn can take distributions over that beneficiary's life expectancy.

The preamble to the Final Income Tax Regulations promulgated under Code section 401(a) (9) (the "Preamble Language") states as follows with respect to the circumstances in which a spousal rollover is available:

> If [a surviving] spouse actually receives a distribution from the IRA, the spouse is permitted to roll that distribution over within 60 days into an IRA in the spouse's own name to the extent that the distribution is not a required distribution, regardless of whether or not the spouse is the sole beneficiary of the IRA owner. Further, if the distribution is received by the spouse before the year that the IRA owner would have been 70 1/2, no portion of the distribution is a required minimum distribution for purposes of determining whether it is eligible to be rolled over by the surviving spouse.

These "spousal rollover" portions of the Code and regulations thereunder are extremely complicated, and often are poorly understood by the average estate planning attorney or accountant, when they are applied to circumstances in which the surviving spouse is not named directly as a beneficiary. Most troubling is the fact that a significant number of retirement plan and IRA plan sponsors are now requiring that a surviving spouse obtain a private letter ruling before the plan sponsor will allow a spousal rollover to be made when an estate or trust, and not the spouse, is named as beneficiary. As a result, the many private rulings addressing this issue (discussed below) and the Preamble Language itself in many cases effectively have been rendered moot. The cost to both the IRS and taxpayers of each taxpayer having to request a private ruling in this circumstance will be enormous.

Therefore, a Revenue Ruling is needed addressing spousal rollovers of a decedent's interest in a Retirement Plan or IRA (the "Decedent's Interest") where an estate or trust (not the surviving spouse) is the named beneficiary of such Decedent's Interest.

Private Rulings:

The IRS has issued many private letter rulings, going back more than a decade,[1] in which a surviving spouse was allowed to roll over a Decedent's Interest even though the beneficiary of the Decedent's Interest in the Retirement Plan or IRA was the decedent's estate or trust. In each of the private letter rulings, the rollover was valid because the surviving spouse was either the executor or trustee of the estate or trust, was in control, and was the sole person who could make the decision to distribute the Decedent's Interest to the surviving spouse. In other words, the Decedent's Interest was *not* treated as having passed through a third-party estate or trust. Instead, the surviving spouse was treated as having received the Decedent's Interest from the decedent.

A recent ruling, PLR 200807025 (Nov. 23, 2007), allowed a spousal rollover where an IRA passed to an estate and became part of a grantor trust which became irrevocable upon the grantor's death. The IRA could have been allocated to any one of four separate subtrusts. The surviving spouse was *not* in complete control of the distributions from the trust. One Co-Trustee of the Marital Trust was the spouse. She and the other Co-trustee of the Marital Trust were required to approve the allocation of the Decedent's Interest to the Marital Trust. The spouse then withdrew the Decedent's Interest from the Marital Trust and requested a favorable ruling that she could roll over the withdrawal to an IRA maintained in her name. The IRS granted her request and quoted the Preamble Language for justification.

In a recent Webcast, however, an IRS representative indicated that the Preamble Language should be read as applying only when the surviving spouse has control and that PLRs similar to 200807025 will likely *not* be granted. He explained that the taxpayer in that private ruling represented that there was no choice as to how the IRA would be allocated among the trusts presented in that fact pattern.

Need for Guidance:

A Revenue Ruling is necessary in order to provide assurance to plan sponsors and guidance to taxpayers as to the circumstances under which a spousal rollover is valid if an estate or trust is named as the beneficiary. As mentioned above, such a ruling will avoid the very significant cost to taxpayers and to the IRS of compelling taxpayers faced with these circumstances to request a private ruling to address this issue, a requirement that is being placed on taxpayers by a significant number of plan sponsors.

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[1] *See, e.g.*, PLR 200324059 (Mar. 18, 2003); PLR 200634065 (April 7, 2006); PLR 200637033 (June 20, 2006), for three examples of more recent rulings.

Further, taxpayers may not rely on private letter rulings granted to others.[2] This means that, regardless of the interpretation applied to the Preamble Language in private letter rulings, practitioners may not wish to recommend spousal rollovers when an estate or trust, rather than the spouse, is named as the beneficiary unless they obtain a private letter ruling for the client or the IRS makes its position official, such as by issuing a revenue ruling. Given the ubiquitous nature of retirement plans and IRAs, such an official position would be of great benefit to all.

In addition, clarifying the meaning of the Preamble Language would be beneficial. Based upon the private letter rulings and informal statements from IRS representatives, it is unclear whether a surviving spouse must be in complete control of the distribution for a rollover to be valid, or whether the spouse can roll over the distribution to a spousal IRA regardless of whether the spouse is in control of the distribution as long as a spouse receives a distribution pursuant to the terms of the estate or trust.

Proposed Resolution:

We respectfully request that the IRS issue as soon as practicable a revenue ruling (or other pronouncement upon which taxpayers may rely) that a spousal rollover may be accomplished by a surviving spouse with a distribution (other than a required minimum distribution) actually received by him or her from a deceased spouse's qualified retirement plan or IRA even though a trust or estate is named as the beneficiary of that qualified retirement plan or IRA.

In addition, the ruling should clarify whether spousal control over the distribution from the trust or estate named as beneficiary is or is not required.

In our view, based on the Preamble Language, it seems that it is sufficient for a valid spousal rollover that the spouse actually receives a distribution of the Decedent's Interest in accordance with the terms of the decedent's estate or trust or governing state law. Therefore, control by the spouse should not be required. However, clarification of this point, regardless of the outcome, is essential to provide certainty in this area and eliminate the need for seeking individual private letter rulings in order to complete a spousal rollover.

We appreciate your attention to this request.

Very truly yours,

Dennis I. Belcher,
President

[2] Internal Revenue Code §6110(k)(3).