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An Estate Planning World in Which Dispositive Objectives, State Tax Laws and Income Taxes Now Predominate For All But The Top 0.2% -- A View from the Audience At Heckerling (2015)

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The recently concluded 49th Annual Heckerling Institute on Estate Planning built upon the groundbreaking themes which dominated the previous year's conference that had challenged estate planners to take a fresh look at the role of income tax (and income tax basis) planning in advising our clients. We're now another year down the road since the massive transformation in the overall estate planning landscape that was ushered in by the American Taxpayer Relief Act of 2012 ("ATRA"). The consensus at this year's Heckerling conference was that for all but the top 0.2% of American society, the most vital functions of the estate planner are to implement the client's dispositive objectives, consider ways to minimize state estate taxes, and maximize opportunities to save income taxes (including via portability of the applicable exclusion amount of the first spouse to die to maximize the extent of the step-up in basis upon the second spouse's death).

Given the ever-changing myriad of federal and state transfer tax and income tax laws that may potentially apply to a particular client, and the extremely difficult-to-predict variable of the state in which the client's children and grandchildren will ultimately reside, the favored approach continues to be to maintain flexibility in our clients' estate plans through the use of qualified terminable interest property ("QTIP") elections (including "Clayton QTIP" planning) and qualified disclaimer planning. Moreover, long-time stalwarts in the estate planner's toolkit such as generating discounts through family limited partnerships and estate freezes may do some clients more harm than good because such strategies come at potentially severe income tax costs by limiting the extent of the step-up in basis for property acquired from a decedent. Accordingly, in many

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instances, estate plans that made great sense prior to 2013 may need to be revised or unwound.

In addition, stability may be fleeting in certain of the techniques that we use. In particular, there is concern that sales to irrevocable grantor trusts in exchange for a trustee's promissory note may be on the radar both by the IRS in the audit context and in subsequent legislation. Although the extent of this attack is unclear and the consensus view is that estate tax reform is highly unlikely to occur during 2015, the estate planner needs to be mindful of the potential for further upheaval in the estate planning landscape in advising his or her clients.

I. Unwinding Pre-ATRA Transactions

With the drastically expanded estate tax exemptions and the permanence of portability under ATRA, to quote the late Steve Jobs, we now need to "think differently" than we used to prior to ATRA. In many cases, this will lead us to counsel our clients to modify, or to unwind, estate plans that made great sense just a few years ago. Instead, dispositive objectives, state tax law planning and income tax planning now predominate. Such was the message trumpeted at Heckerling including in the excellent presentation of John F. Bergner.

The federal estate tax is simply irrelevant to most U.S. taxpayers. Accordingly, we need to identify those techniques (such as bypass trusts and family limited partnerships) that are no longer needed to save Federal estate taxes, and which, if unchanged, can actually *hurt* our clients by increasing the amount of income taxes to be incurred by the client's beneficiaries after the client dies. This could occur because the pre-ATRA estate plan used a credit shelter trust -- which, absent further planning such as through distributions to the surviving spouse, or conferring a formula-based general power of appointment upon the surviving spouse, eliminates the ability to obtain a step-up in basis of the assets in the credit shelter trust upon the second spouse's death. This could also occur because the estate plan involved the use of entities (such as family limited partnerships or family limited liability companies) that were intended to produce valuation discounts upon death due to the lack of marketability and lack of control of the decedent's entity interest. A valuation discount for estate tax purposes will correspondingly reduce the extent of the step-up in basis and thereby increase income taxes when the entity interest is subsequently sold by the beneficiary.[1]

Further complicating this analysis, however, is that the estate planning is being done in a multi-dimensional prism in which applicable *state* estate taxes need to be factored in as well. So it's not simply a matter of considering federal estate taxes, income taxes and the step-up in basis -- because you don't want the income tax benefit of maximizing the step-up in basis to come at the peril of producing state estate taxes upon the death of the first spouse to die.

The following "unwind" strategies can potentially be employed in our post-ATRA environment to reduce income taxes:

- Avoiding valuation discounts for client-owned assets, including by liquidating family limited partnerships or family limited liability companies or giving the senior family member the unilateral right to liquidate the entity;

- Causing inclusion of assets in the settlor's estate, including through the "offensive use" of sections 2036 and 2038 of the Internal Revenue Code or by having the

settlor purchase the remainder interest in a successful grantor retained annuity trust;

- Causing inclusion of trust assets in a beneficiary's estate, including by giving the beneficiary a general power of appointment to produce estate tax inclusion in the beneficiary's estate under section 2041 of the Internal Revenue Code;

- Changing ownership of spousal assets to achieve a new income tax basis for appreciated assets and to preserve the income tax basis of "loss assets" – for example, a swap of assets between spouses (which will generally be tax-free under IRC § 1041) can allow the spouse with the shorter life expectancy to get the appreciated assets;

- Planning to avoid imposition of the 3.8% net investment income tax;

- Addressing life insurance policies and life insurance trusts that are no longer needed; and

- Turning off grantor trust status to facilitate tax savings on income distributed to beneficiaries who are subject to tax at a lower marginal income tax rate.

II. Sales to Grantor Trusts Funded with Promissory Notes – the Woelbing Case

The Tax Court filings that generated the most buzz at this year's Heckerling Institute involve two related pending cases in which the IRS has challenged a defined value clause sale to a grantor trust in exchange for a promissory note: *Estate of Donald Woelbing v. Commissioner*, Docket No. 30261-13 and *Estate of Marion Woelbing v. Commissioner*, Docket No. 30260-13 (collectively, the "*Woelbing* case").

In *Woelbing*, the taxpayer sold stock in a closely-held business, Carma Laboratories, Inc., to a trust for a $59 million promissory note with interest at the applicable federal rate in effect under section 1274(d) of the Internal Revenue Code. The beneficiaries executed personal guarantees equal to 10% of the purchase price, and the trust already owned insurance policies with cash value of $12.6 million prior to entering into this transaction. The purchase documentation contained a *Wandry*-style (two-party) defined value clause in the event of IRS modification to the valuation of the stock transferred.

The IRS is contending (1) that section 2702 applies and therefore the trust's promissory note should be valued at zero for gift tax purposes; (2) that the stock's value was actually $117 million and a gift resulted to the extent of the amount in excess of the promissory note value, with the defined value clause disregarded; and (3) that sections 2036 and 2038 apply to the stock for estate tax purposes to bring it back into the estate at its fair market value at date of death.

In effect, the IRS's position is that the loan is not a bona fide loan but rather a gift. A critical determinant appears to be whether there was a reasonable expectation of repayment of the loan at the time it was made.[2]

Reminiscent of the celebrated *Karmazin* settlement of more than a decade ago (which is generally regarded as having been a huge taxpayer victory against a similar IRS attack upon a sale to a grantor trust that was funded with a promissory note),[3] this case reinvigorates the age-old question of whether using a grantor retained annuity trust ("GRAT") may be a safer technique than a sale to a grantor trust funded with a promissory note, all

other things being equal. The consensus that seemed to emerge at Heckerling is that clients who are now considering sales to grantor trusts funded with promissory notes should be advised that this case is out there, and that GRATs are clearly safer than sales to grantor trusts (although sales to grantor trusts can be very effective).

A frequently expressed sentiment concerning the *Woelbing* case is that the IRS examiners -- understaffed and running out of time on the statute of limitations -- are throwing in the "kitchen sink" and this is one of their throw-in arguments. That being said, it would appear that the safer course in promissory note sales is to require that the note be secured with collateral (including via a pledge agreement) to rebut a potential IRS argument that there was no reasonable expectation of repayment at the time of the sale.

III. IRS Guidance on the 2-Percent of AGI Floor for Trusts and Estates

Income tax was a hot topic at this year's Heckerling Institute, and considerable attention was devoted to recent IRS guidance on an income tax issue specific to trusts and estates.

On May 9, 2014, the IRS issued final regulations under § 1.67-4 that provide guidance on which costs incurred by estates or trusts other than grantor trusts (non-grantor trusts) are subject to the 2-percent of adjusted gross income floor for miscellaneous itemized deductions under section 67(e) of the Internal Revenue Code (the "2-percent floor"). These final regulations apply to taxable years beginning on or after January 1, 2015, and has created enormous concern among corporate fiduciaries in particular. Chief among these concerns is how a fiduciary should go about subdividing (or "unbundling") a single fiduciary fee that represents a composite of various functions that the fiduciary has performed, including the providing of investment advice (which is generally subject to the 2-percent floor) and managing other aspects of its relationship with beneficiaries including distribution decisions (which is not subject to the 2-percent floor).

The stakes involved here are much higher than one might otherwise expect. Miscellaneous itemized deductions that are subject to the 2-percent floor are disallowed entirely for purposes of the alternative minimum tax ("AMT").[4] So for those trusts and estates in an AMT posture, this is not simply a matter involving a small potential reduction in the after-tax cost of particular expenses. Rather, it may well be an "all or nothing" proposition as to whether significant expenses are effectively deductible at all.

The Basic Rules

IRC § 67(e) provides an exception to the 2-percent floor on miscellaneous itemized deductions for costs that are paid or incurred in connection with the administration of an estate or a non-grantor trust "that would *not* have been incurred if the property were *not* held in such estate or trust."[5] A cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust, and "commonly or customarily would be incurred" [6] by a hypothetical individual holding the same property.

This standard raises the question of what it means for a cost to be "commonly or customarily incurred" by a hypothetical individual holding the same property. The Regulations instruct that "[i]n analyzing a cost to determine whether it commonly or customarily would be incurred by a hypothetical individual

owning the same property, it is the type of product or service rendered to the estate or non-grantor trust in exchange for the cost, rather than the description of the cost of that product or service, that is determinative."[7] Such costs that are incurred commonly or customarily by individuals (which would be subject to the 2-percent floor) include, for example, costs incurred in defense of a claim against the estate, the decedent, or the non-grantor trust that are unrelated to the existence, validity, or administration of the estate or trust,[8] and ownership costs (including those that pass through to the trust or estate from a partnership).[9]

In addition, the Final Regulations provide guidance concerning the following specific categories of costs:

- Tax preparation fees. Costs relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor. The costs of preparing all other tax returns (for example, gift tax returns) are costs commonly and customarily incurred by individuals and thus are subject to the 2-percent floor.[10]

- Appraisal fees. Appraisal fees incurred by an estate or a non-grantor trust to determine the fair market value of assets as of the decedent's date of death (or the alternate valuation date), to determine value for purposes of making distributions, or as otherwise required to properly prepare the estate's or trust's tax returns, or a generation-skipping transfer tax return, are not incurred commonly or customarily by an individual and thus are not subject to the 2-percent floor. The cost of appraisals for other purposes (for example, insurance) is commonly or customarily incurred by individuals and is subject to the 2-percent floor.[11]

- Certain Fiduciary Expenses. Certain other fiduciary expenses are not commonly or customarily incurred by individuals, and thus are not subject to the 2-percent floor. Such expenses include without limitation the following: probate court fees and costs; fiduciary bond premiums; legal publication costs of notices to creditors or heirs; the cost of certified copies of the decedent's death certificate; and costs related to fiduciary accounts.[12]

The Special Case of Investment Advisory Fees

The Final Regulations provide that fees for investment advice (including any related services that would be provided to any individual investor as part of an investment advisory fee) are incurred commonly or customarily by a hypothetical individual investor and therefore are subject to the 2-percent floor. This basic rule gets complicated, however, as a result of the Final Regulations' attempt to follow the imprimatur of the United States Supreme Court's 2008 decision in *Knight v. Commissioner*, 552 U.S. 181, 128 S. Ct. 782 (2008). The Supreme Court, in *Knight*, held that fees paid to an investment advisor by an estate or non-grantor trust generally are subject to the 2-percent floor, subject to certain potential exceptions. These potential exceptions are where "the rubber hits the road," so to speak. Following the Supreme Court's instructions in *Knight*, the Final Regulations provide that certain incremental costs of investment advice beyond the amount that normally would be charged to an individual investor are not subject to the 2-percent

floor. For this purpose, such an incremental cost is a special, additional charge that is added solely because the investment advice is rendered to a trust or estate rather than to an individual or attributable to an unusual investment objective or the need for a specialized balancing of the interests of various parties (beyond the usual balancing of the varying interests of current beneficiaries and remaindermen) such that a reasonable comparison with individual investors would be improper. The portion of the investment advisory fees not subject to the 2-percent floor by reason of the preceding sentence is limited to the amount of those fees, if any, that exceeds the fees normally charged to an individual investor. [13]

Bundled Fees

Another area of considerable uncertainty under the Final Regulations results from its requirement that "bundled fees" be unbundled into a portion that is subject to the 2-percent floor and a portion that is not subject to the 2-percent floor. The Final Regulations provide that "[i]f an estate or a non-grantor trust pays a single fee, commission, or other expense (such as a fiduciary's commission, attorney's fee, or accountant's fee) for both costs that are subject to the 2-percent floor and costs (in more than a de minimis amount) that are not, then, except to the extent provided otherwise by guidance published in the Internal Revenue Bulletin, the single fee, commission, or other expense (bundled fee) must be allocated, for purposes of computing the adjusted gross income of the estate or non-grantor trust in compliance with section 67(e), between the costs that are subject to the 2-percent floor and those that are not." [14]

The Final Regulations provide an important exception to having to unbundle fees where a bundled fee is not computed on an hourly basis. In that case, only the portion of that fee that is attributable to investment advice is subject to the 2-percent floor; the remaining portion is not subject to the 2-percent floor. [15] Although the Final Regulations are unclear on this point, presumably the Final Regulations' guidance (in accordance with the Supreme Court's instructions in *Knight*) that certain incremental costs of investment advice beyond the amount that normally would be charged to an individual investor are not subject to the 2-percent floor would also apply here.

In addition, out-of-pocket expenses billed to the estate or non-grantor trust are treated as separate from the bundled fee. In a similar vein, payments made from the bundled fee to third parties that would have been subject to the 2-percent floor if they had been paid directly by the estate or non-grantor trust are subject to the 2-percent floor, as are any fees or expenses separately assessed by the fiduciary or other payee of the bundled fee (in addition to the usual or basic bundled fee) for services rendered to the estate or non-grantor trust that are commonly or customarily incurred by an individual. [16]

According to the Final Regulations, *any reasonable method may be used* to allocate a bundled fee between those costs that are subject to the 2-percent floor and those costs that are not. Facts that may be considered in determining whether an allocation is reasonable include, but are not limited to, the percentage of the value of the corpus subject to investment advice, whether a third party advisor would have charged a comparable fee for similar advisory services, and the amount of the fiduciary's attention to the trust or estate that is devoted to investment advice as compared to dealings with beneficiaries and distribution decisions and other fiduciary functions. The reasonable method standard does not apply to determine the

portion of the bundled fee attributable to payments made to third parties for expenses subject to the 2-percent floor or to any other separately assessed expense commonly or customarily incurred by an individual, because those payments and expenses are readily identifiable without any discretion on the part of the fiduciary or return preparer.[17]

How then are corporate fiduciaries handling the allocation of a bundled fiduciary fee between the portion that is subject to the 2-percent floor (such as for "basic" investment advice) and the portion that is not (potentially everything else)? This question was posed to the esteemed Recent Developments Panel consisting of Dennis Belcher, Carlyn McCaffrey and Samuel Donaldson, who in turn took a very informal straw poll of corporate fiduciaries attending Heckerling. The following two responses were reported:

- one corporate fiduciary has formed a committee to look into this issue, and
- another corporate fiduciary has taken the following approach:
  - *for trusts* – 60% of the bundled fiduciary fee is allocated to investment advice, with 40% not subject to the 2-percent floor; and
  - *for estates* – 20% of the bundled fiduciary fee is allocated to investment advice, with 80% not subject to the 2-percent floor.

IV. Trust Material Participation in Passive Activities -- the Frank Aragona Trust Case

Also under the heading of income taxes, there is a significant open question concerning how a trust can materially participate in passive activities and thereby avoid the 3.8% surcharge on net investment income under IRC § 1411. The Treasury and IRS are of the view that the issue of the application of the 3.8 percent tax to trusts and estates under section 1411 cannot be addressed except in the broader context of the passive loss rules of section 469. The issuance of guidance regarding material participation by trusts and estates for purposes of section 469 appears on the 2014-2015 Treasury-IRS Priority Guidance Plan, but no regulatory guidance has been issued to date. In the interim, taxpayers, the IRS and the courts have grappled with determining what constitutes material participation by a trust in a passive activity.

Against this backdrop of the current regulatory vacuum we have the Tax Court's decision in *Frank Aragona Trust v. Commissioner*, 142 T.C. No. 9 (2014). In *Aragona,* the trust operated its rental real estate activity primarily through a wholly-owned limited liability company. The trust's other real estate activities were conducted through several separate entities, some wholly owned and others in which the trust owned a majority interest. The trust had six trustees – three of whom were employees of the rental real estate business owned in part by the trust.

The IRS's position in this case was that, for purposes of the passive loss rules of section 469, a trust only participates where the trustee materially participates in the activity, and no attribution of participation to the trustee should be allowed where the trustee wears another fiduciary hat as well.

The principal issues before the Tax Court were: (1) whether the trust could qualify for treatment as a "real estate professional" and deduct rental real estate losses, and (2) whether the trust materially participated in the real estate business through the activities of its

trustees and/or employees. The taxpayer ultimately prevailed on both issues, with the Tax Court holding that a trust could qualify for the real estate professional exception, and that the trust had materially participated through the actions of its trustees. Importantly, however, the Tax Court declined to rule on the issue that had been previously decided in favor of the taxpayer in *Mattie K. Carter Trust v. United States*, 256 F. Supp. 2d 536 (N.D. Tex. 2003) – namely, whether the activities of the trust's non-trustee employees should be disregarded for this purpose. Rather, the court held that the direct actions of the trustees were sufficient to carry the day in this case.

The Tax Court's analysis in *Aragona* was very fact-intensive focusing, among other things, upon the trustees' involvement in managing the day-to-day operations of the trust's various real estate businesses. It therefore highlights the importance of documenting a trustee's day-to-day involvement in real estate activities to help ward off IRS challenges to the trustee's material participation for purposes of both sections 469 and 1411.

V. Fractional Interest Discounts in Works of Art – the Elkins Case

The year 2014 also saw a great taxpayer victory in *Estate of Elkins v. Commissioner*, 767 F.3d 443 (5th Cir. 2014), *aff'g in part and rev'g in part* 140 T.C. 86 (2013). In *Elkins*, the decedent owned fractional interests in various works of art. The IRS and the taxpayer disagreed on whether a discount should be allowed, with the IRS asserting no discount without proffering any evidence while the estate argued for discounts of nearly 67 percent supporting its position with expert testimony. The Tax Court allowed a 10 percent discount. The United States Court of Appeals for the Fifth Circuit agreed with the Tax Court that there should be a discount allowed, but parted company with the Tax Court on the extent of the discount, adopting the estate's position of a nearly 67 percent discount. As the court noted, the IRS utterly failed to provide any evidence in support of a lower discount than that asserted by the estate. At the end of the day, *Elkins* may be a case that stands most for the significance of meeting a litigant's burden of proof.

VI. What Lurks on the Horizon?

Finally, Heckerling always presents an opportunity for crystal ball gazing, and the principal fodder for such prognostication can include the Obama Administration's "Greenbook" proposals. This year was no different, and the author now also has the benefit of the Obama Administration's Fiscal Year 2016 Greenbook proposals, which were issued shortly after Heckerling.

A Special $50,000 Capped Category of Annual Exclusions for Trusts?
There seems to be momentum towards establishing a "$50,000 super-category" of annual exclusion gifts that would envelop all of a donor's gifts to trusts. The IRS does not like the use of "Crummey" powers in trusts to generate multiple annual exclusions by having the terms of the trust or other governing instrument confer upon a multitude of beneficiaries rights of withdrawal that will likely go unexercised notwithstanding that notices may be given to the beneficiaries by the trustee and carefully documented.

As clarified in its 2016 Greenbook, the Administration's proposal would eliminate the present interest requirement for gifts that qualify for the gift tax annual exclusion. Instead, the proposal would define a new category of transfers (without regard to the existence of any withdrawal or put rights), and would impose an annual limit of

$50,000 (indexed for inflation after 2016) *per donor* on the donor's transfers of property within this new category that will qualify for the gift tax annual exclusion. This new $50,000 per-donor limit would not provide an exclusion in addition to the annual per-donee exclusion; rather, it would be a further limit on those amounts that otherwise would qualify for the annual per-donee exclusion. Thus, a donor's transfers in the new category in a single year in excess of a total amount of $50,000 would be taxable, even if the total gifts to each individual donee did not exceed $14,000. The new category would include transfers in trust (other than to a trust described in section 2642(c)(2)), transfers of interests in passthrough entities, transfers of interests subject to a prohibition on sale, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee. The proposal would be effective for gifts made after the year of enactment.

Oh Canada!

Finally, discussion is warranted of the capital gains tax provisions that are contained in the Obama Administration's Fiscal Year 2016 Greenbook Proposals. In addition to repeating such stalwarts of the 2015 Greenbook as restoring certain of the estate, gift and generation-skipping transfer tax parameters in effect in 2009, eliminating certain tax benefits that can be derived from sales and other transactions with grantor trusts, and imposing a ten-year minimum term requirement for GRATs -- although with the new wrinkle of also imposing a 25% minimum remainder requirement, with the amount of the taxable gift to be at least $500,000 (but capped at the value of the property contributed to the GRAT) -- there is a significant new proposal that can only be described as "Oh Canada!"

Following Canada as a model with respect to imposing a capital gains tax upon appreciation in the value of property through a person's death, and then extending this principle to apply as well to lifetime gifts of appreciated property, the Administration's proposal would generally treat transfers of appreciated property as tantamount to a taxable sale. The donor or deceased owner of an appreciated asset would realize a capital gain at the time the asset is given or bequeathed to another. The amount of the gain realized would be the excess of the asset's fair market value on the date of the transfer over the donor's basis in that asset. That gain would be taxable income to the donor in the year the transfer was made, and to the decedent either on the final individual return or on a separate capital gains return. The unlimited use of capital losses and carry-forwards would be allowed against ordinary income on the decedent's final income tax return, and the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate (if any). Gifts or bequests to a spouse or to charity would carry the basis of the donor or decedent. Capital gain would not be realized until the spouse disposes of the asset or dies, and appreciated property donated or bequeathed to charity would be exempt from capital gains tax.

The Administration's proposal would exempt any gain on all tangible personal property such as household furnishings and personal effects (excluding collectibles). The proposal also would allow a $100,000 per-person exclusion of other capital gains recognized by reason of death that would be indexed for inflation after 2016, and would be portable to the decedent's surviving spouse under the same rules that apply to portability for estate

and gift tax purposes (making the exclusion effectively $200,000 per couple). The $250,000 per person exclusion under current law for capital gain on a principal residence would apply to all residences, and would also be portable to the decedent's surviving spouse (making the exclusion effectively $500,000 per couple).

The exclusion under current law for capital gain on certain small business stock would also apply. In addition, payment of tax on the appreciation of certain small family-owned and family operated businesses would not be due until the business is sold or ceases to be family-owned and operated. The proposal would further allow a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made.[18]

The Administration's proposal also would increase the highest long-term capital gains and qualified dividend tax rate from 20 percent to 24.2 percent. The 3.8 percent net investment income tax would continue to apply as under current law. Thus, the maximum total capital gains and dividend tax rate including net investment income tax would thus rise to 28 percent.

To facilitate the transition to taxing gains at death and gift, the IRS would be granted authority to issue any regulations necessary or appropriate to implement the proposal, including rules and safe harbors for determining the basis of assets in cases where complete records are unavailable. This proposal would be effective for capital gains realized and qualified dividends received in taxable years beginning after December 31, 2015, and for gains on gifts made and of decedents dying after December 31, 2015.

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[1] A reduction in the extent of the step-up in basis will also reduce depreciation deductions on depreciable property.

[2] A related question that the IRS has apparently asserted in other audits is whether the promissory note is worth its face value, even if the interest rate on the promissory note is at the applicable federal rate in effect under section 1274(d) of the Internal Revenue Code.

[3] In the *Karmizin* case, Tax Court Docket No. 2127-03, in addition to contending that the sale to the trust was a retained interest that didn't satisfy the qualified interest rules under section 2702 (and therefore worth zero for gift tax purposes), the IRS treated the promissory note as a second class of equity that didn't satisfy the requirements of section 2701 (and therefore worth zero on that basis as well). It does not appear that the section 2701 argument has been asserted by the IRS in *Woelbing*.

[4] IRC § 56(b)(1)(A)(i).

[5] Treas. Reg. § 1.67-4(a) (emphasis added).

[6] Treas. Reg. § 1.67-4(a).

[7] Treas. Reg. § 1.67-4(b)(1).

[8] Treas. Reg. § 1.67-4(b)(1).

[9] Treas. Reg. § 1.67-4(b)(2).

[10] Treas. Reg. § 1.67-4(b)(3).

[11] Treas. Reg. 1.67-4(b)(5).

[12] Treas. Reg. 1.67-4(b)(6).

[13] Treas. Reg. § 1.67-4(b)(4).

[14] Treas. Reg. § 1.67-4(c)(1).

[15] Treas. Reg. § 1.67-4(c)(2).

[16] Treas. Reg. § 1.67-4(c)(3).

[17] Treas. Reg. § 1.67-4(c)(3).

[18] The Administration's proposal also would include other legislative changes designed to facilitate and implement this proposal, including: the allowance of a deduction for the full cost of appraisals of appreciated assets; the imposition of liens; the waiver of penalty for underpayment of estimated tax

if the underpayment is attributable to unrealized gains at death; the grant of a right of recovery of the tax on unrealized gains; rules to determine who has the right to select the return filed; the achievement of consistency in valuation for transfer and income tax purposes; and a broad grant of regulatory authority to provide implementing rules.

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