

Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2940

Date: 01-Mar-22

From: Steve Leimberg's Estate Planning Newsletter

Subject: [Ashley Case, Joy Matak, Matthew Rak & Martin M. Shenkman on CCA 202152018](#)
- Lessons for a Multi-Disciplinary, Collaborative Approach to Planning

□ CCA [202152018](#) includes significant analysis by the Office of Chief Counsel which may impact popular estate planning strategies. While much has been made of the CCA's impact on grantor retained annuity trusts (GRATs), there may be implications from the CCA for estate planning more generally. This newsletter analyzes the CCA and provides suggestions of possible planning implications based on the Treasury's positions as set forth in the CCA.

The Office of the Chief Counsel interprets the internal revenue laws and issues legal guidance and interpretive advice in the form of publicly available memoranda, commonly known as Chief Counsel Advice or CCA. [\[i\]](#) CCAs cannot be used or cited as legal precedent, nor can taxpayers rely on them. However, they do offer evidence of how Treasury concluded when presented with specific sets of facts. CCAs can provide a fruitful glimpse of the positions that Treasury is likely to take and can be a predictor of potential pitfalls in particular strategies.

Finally, while the CCA lays out a brief factual summary, an analysis of the issues presented, the governing law that was considered, and the chief counsel's recommendations, it does not provide the entire background on the plan or its implementation. Nothing in this article should be interpreted as a critique of the practitioners involved in the planning as insufficient information is available to comment. □

Ashley Case, Joy Matak, Matthew Rak and Martin M. Shenkman provide members with commentary that examines the implications of CCA [202152018](#) on GRATs specifically and estate planning generally. Their commentary previously appeared in the NAEPC Journal.

Ashley L. Case (J.D., LL.M., AEP) is a **Shareholder** at **Tiffany & Bosco, P.A.** in Phoenix, Arizona. Her practice concentrates on estate and tax planning and trust and estate administration. She serves on the Board of Directors of the Central Arizona Estate Planning Council (the local affiliate of the National Association of Estate Planning Councils), the Board of Directors of the Maricopa County Bar Association (MCBA), and is the Past

Chair of the MCBA Estate Planning, Probate, and Trust Section. In addition to writing and speaking about estate planning, Ms. Case is an avid adventure seeker. She enjoys mountaineering and is currently training to summit Mt. Kilimanjaro in June 2022 to raise funds for the Arizona Burn Center at Valleywise Hospital in Phoenix.

Joy Matak, JD, LLM is a **Partner** at **Sax** and Head of the firm's **Trust and Estate Practice**. She has more than 20 years of diversified experience as a wealth transfer strategist with an extensive background in recommending and implementing advantageous tax strategies for multi-generational wealth families, owners of closely-held businesses, and high-net-worth individuals including complex trust and estate planning. Joy provides clients with wealth transfer strategy planning to accomplish estate and business succession goals. She also performs tax compliance including gift tax, estate tax, and income tax returns for trusts and estates as well as consulting services related to generation skipping including transfer tax planning, asset protection, life insurance structuring, and post-mortem planning. Joy presents at numerous events on topics relevant to wealth transfer strategists including engagements for the ABA Real Property, Trust and Estate Law Section; Wealth Management Magazine; the Estate Planning Council of Northern New Jersey; and the Society of Financial Service Professionals. Joy has authored and co-authored articles for the Tax Management Estates, Gifts and Trusts (BNA) Journal; Leimberg Information Services, Inc. (LISI); and Estate Planning Review The CCH Journal, among others, on a variety of topics including wealth transfer strategies, income taxation of trusts and estates, and business succession planning. Joy recently co-authored a book on the new tax reform law.

Matthew Rak is a partner in the **Estates and Trusts** and **Tax-Exempt Organizations** groups of **Leech Tishman Fuscaldo & Lampl, LLC**. He practices primarily in Pittsburgh, Pennsylvania

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in Fort Lee, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and more than 1,200 articles. He is a member of the NAEPC Board of Directors (Emeritus), on the Board of the American Brain Foundation, the American Cancer Society's National Professional Advisor Network and Weill Cornell Medicine Professional Advisory Council.

Here is their commentary:

EXECUTIVE SUMMARY:

CCA [202152018](#), released on December 30, 2021 (the "CCA"), includes significant analysis by the Office of Chief Counsel which may impact popular estate planning strategies. While much has been made of the CCA's impact on grantor retained annuity trusts (GRATs), there may be implications from the CCA for estate planning more generally. ^[iii] This newsletter analyzes the CCA and provides suggestions of possible planning implications based on the Treasury's positions as set forth in the CCA.

The Office of the Chief Counsel interprets the federal tax laws and issues legal guidance and interpretive advice in the form of publicly available memoranda, commonly known as Chief Counsel Advice or CCA. ^[iii] CCAs cannot be used or cited as legal precedent, nor can taxpayers rely on them. However, they do offer evidence of how Treasury concluded when presented with specific sets of facts. CCAs can provide a fruitful glimpse of the positions that Treasury is likely to take and can be a predictor of potential pitfalls in particular strategies.

Finally, while the CCA lays out a brief factual summary, an analysis of the issues presented, the governing law that was considered, and the chief counsel's recommendations, it does not provide the entire background on the plan at issue or its implementation. Nothing in this article should be interpreted as a critique of the planning or the practitioners involved, as insufficient information is available to comment.

FACTS:

Before publishing advice, the Office of Chief Counsel redacts any taxpayer identifying information including names, addresses, and specific details about the transactions under review. For high net worth and well-known taxpayers, a CCA may omit dates, dollar amounts, percentages, the taxpayer's industry, geographic location, business relationships, or associations, in order to protect the identity of the taxpayer who is the subject of the opinion. As a result, the recitation of facts in a CCA can be so obtuse as to be difficult to interpret. Therefore, as a foundation for the

discussions that follow, a fictional narrative and timeline inferred from the facts as set forth in the CCA, have been used for the taxpayer (□Taxpayer□) and the business (□Company□) at issue. Additionally, the Chief Counsel did not include the actual dollar amounts in its opinion, so, to facilitate discussion, hypothetical numbers are used.

Hypothetical Narrative Timeline (Figure 1.)^[iv]

Taxpayer is the founder of Company.

On December 31, 2015, Company obtained a valuation to satisfy the reporting requirements for nonqualified deferred compensation plans under Sect. 409A. The CCA did not specify the per share value. For illustration purposes, consider that the December 2015 Sect. 409A valuation set the value of the Company at \$1,000 per share.

Around the same time, at the end of 2015, Taxpayer started to market Company for sale □through outreach by investment bankers to potential strategic buyers,^[v] some of whom had previously expressed interest in partnering with Company.□^[vi]

From June 15, 2016 through June 30, 2016, Company received offers from five different corporations □in the multi-billion dollar range□ to acquire the company.

Three days later, on July 3, 2016, Taxpayer funded a two-year grantor retained annuity trust (□GRAT□) with shares of stock in Company. The CCA did not specify how many shares of stock in Company were gifted to the GRAT. For illustration purposes only, consider that Taxpayer gifted 100,000 shares of stock in Company to the GRAT with a cash value of \$100 million. Under the terms of the trust agreement, the annuity payments were calculated on a fixed percentage based upon the initial fair market value of the shares in Company. For the purposes of this discussion, Taxpayer would have calculated that two annuity payments required back to her from the GRAT based on the value of the original contribution to be \$51,353,156 each, which payments would have been required to have been paid within one hundred five days of the anniversary dates of the GRAT funding, i.e., on July of 2017 and July of 2018, at which point the GRAT would have terminated.^[vii]

On September 30, 2016, four of the five original corporations increased their offers on Company (the remaining corporation withdrew). From the facts presented in the CCA, these offers

exceeded the initial price per share determined by the 409A valuation by a multiple close to three. In other words, the offer price in the fall of 2016 for Company would have been around \$2,850 per share (using our hypothetical numbers of an initial value of \$1,000 per share).

On November 15, 2016, Taxpayer created a charitable remainder trust (CRT) and funded it with shares based on the high-offer price of \$2,850 per share, which was supported by a current valuation qualifying for charitable deduction purposes. If Taxpayer also funded the CRT with 100,000 shares, the CRT contribution would be \$285 million, contrasted with the GRAT transfer of \$100 million less than five months earlier. To the extent that the Taxpayer had created a normal twenty-year charitable remainder unitrust, optimized for maximum tax deductibility and unitrust factor, she would have been entitled to a charitable contribution deduction in 2016 of just over \$28.5 million, as well as an annual payout of 10.875% of the trust corpus to her.^[viii]

In December 2016, Company accepted the tender offer of \$2,850 per share from the high bidder.^[ix]

On December 31, 2016, a new 409A valuation set the fair market value of Company at \$2,000 per share. This valuation included a statement □ according to management, there have been no other recent offers or closed transaction in Company shares as of the valuation date. □

On April 15, 2017 (or October 15, if extended) the 2016 Gift Tax Return would have been due.

On December 31, 2017, another 409A valuation was performed with similar results and also included the statement regarding recent offers and closed transactions.

According to the CCA, it appears that the GRAT sold the remaining shares in late 2018 or early 2019, about 6 months after the two-year GRAT term would have ended, with the proceeds from the sale deposited for the benefit of the GRAT remaindermen.

The Holding of the CCA

According to the CCA, Taxpayer relied on the 409A appraisal to set the value of the assets transferred to the GRAT in July of 2016. The 409A appraisal focused exclusively on the business operations occurring around the December 31, 2015 valuation date. Taxpayer made no adjustments to the earlier appraisal that might have reflected the search for buyers, the ongoing merger negotiations, or the offers that had been actually received in the days before the GRAT was funded.

The differences between the value determined by the 409A valuation, and the offers received by Taxpayer, are illustrated in the calculations below.

The CCA concluded that the value of the shares should have been higher than that set forth in the 409A appraisal, though perhaps not as high as the offer of \$2,850 per share made by the strategic buyer as that bid had not been actually received at the time the GRAT was funded. Assuming that a fair value of the shares transferred was \$2,000 each, the GRAT would have required payments of over \$102 million annually for two years, or about \$205 million in total annuity payments, in order to net the gift to zero, an amount which exceeded the actual annuity paid by more than \$100 million.^[x] Ultimately, such an adjustment would have reduced the net remainder transferred to the GRAT remaindermen from \$182.4 million to \$79.8 million.

The CCA inferred that the 409A valuation may not have been valid for two reasons. First, it did not consider pending offers and acquisitions that were occurring at the time the GRAT was funded. Second, the CCA suggested that the taxpayer likely knew of potential offers impacting the value as the bidders had "previously expressed interest" in the company.:

The CCA held that the taxpayer used a "misleading and outdated" valuation to "depress the required annual annuity" [by] tens of millions of dollars that otherwise should have been paid by the GRAT to Taxpayer, had the original gift to the GRAT been valued appropriately and called into question the good faith motives of the taxpayer.

In the Chief Counsel's view, the GRAT's "failure to satisfy the 'fixed amount' requirement" is an operational failure because the trustee paid an amount that had no relation to the initial fair market value of the property transferred to the trust.^[xi] Therefore, the CCA concluded that the GRAT

transfer in July of 2016 was deemed to have been made to a trust that did not qualify as a grantor retained annuity trust as a matter of law, under the relevant statutes and regulations.

Undervaluing GRAT Contribution as Precursor to GRAT Failure?

GRAT instruments are commonly drafted to express the annuity owed back to the grantor as a percentage of the fair market value of the gifted property, rather than as a fixed amount, particularly when hard-to-value assets such as closely held businesses are transferred to the GRAT. The objective is that the percentage will force the annuity payments to self-adjust if the value of the underlying asset is successfully challenged, thereby leaving the ultimate gift amount substantially unchanged.

In the CCA, consider that Taxpayer transferred 100,000 shares of Company to the GRAT in exchange for an annuity of 51.353% annually. No matter the value as finally determined for gift tax purposes of the Company, shares of stock transferred, the GRAT instrument was drafted so that Taxpayer will still be deemed to have made a so-called zeroed out gift.

This is a common strategy with GRATs and is the mechanism by which a GRAT can self-adjust if there is a challenge on the valuation. When the annuity is expressed as a percentage of the fair market value, the annuity amount should adjust so that the gift value remains substantially unchanged. This formula is why GRATs have been favored in some transactions, as practitioners have assumed that this GRAT valuation adjustment mechanism would protect the transaction from gift tax exposure.

However, the Chief Counsel undermines this traditional thinking by concluding that the gift value of the shares transferred exceeded the taxpayer's initial valuation by so much that no such adjustment under the regulations would be permitted since the GRAT was an "operational failure." In coming to this conclusion, the Chief Counsel determined that the transfer to the GRAT could not be offset by the annuity interest retained by Taxpayer since it was not a "qualified annuity interest" as that term is defined under Treas. Reg. Section 25.2702-3(d)(1).

Thus, to the extent that the value of the shares contributed by Taxpayer to the GRAT was finally determined for gift tax purposes to be worth \$2,000 per share, Taxpayer would be deemed to have made a gift worth \$200 million, notwithstanding the fact that the GRAT by its terms appears to owe Taxpayer an annuity with a present value of \$[199,999,999](#).^[xii]

Application of the *Atkinson* Case

The Chief Counsel pointed out that the annuity owed to Taxpayer could not be a "qualified annuity interest" since it was based on an asset value that was, in Chief Counsel's opinion, deliberately understated. The CCA cited the Tax Court case of *Atkinson v. Commissioner*, wherein Melvine Atkinson had created a charitable remainder annuity trust (CRAT) two years prior to her death.^[xiii] The parties stipulated that the trust instrument satisfied the statutory requirement that the CRAT pay out an annuity to Mrs. Atkinson "equal to 5 percent of the fair market value of the assets of the trust as of the date of its creation, in equal quarterly payments, until her death."^[xiv] The parties also stipulated that no payments were actually made to Mrs. Atkinson before her death.

In framing the issue before it, the *Atkinson* Tax Court tied the question of "whether the trust made the statutorily required payments to decedent" to the conclusion about whether "the trust was **operationally qualified**."^[xv] After analyzing the facts and the applicable law, the Tax Court agreed with the IRS that the trust could not be a valid CRAT under Sect. 664(d)(1) and the corresponding regulations because the required annual annuity amount was never paid and so could not have been a qualified annuity interest. Essentially, even though the trust instrument itself met the CRAT requirements in form, the actual administration of the trust did not honor those requirements and therefore the CRAT failed.

The CCA did not suggest that the GRAT failed to make annuity payments under the terms of the instrument to Taxpayer. Rather, the charge from Chief Counsel is that to the extent any annuity payments had been made, the payments were wholly inadequate since they were based on a depressed value of the initial contribution of the shares to the GRAT.

The Chief Counsel made a slightly nuanced argument from that presented by the Commissioner and adopted by the Tax Court in *Atkinson*. Whereas no payments were made in *Atkinson* when they were due, all information available suggests that the GRAT did make the payments to Taxpayer based on the initial value of the contribution to the GRAT, as required by

the statute and relevant regulations. To the Chief Counsel, it appears to have been an order of magnitude. The CCA position appears to be that because the difference in the annuity that was paid by the GRAT to Taxpayer was much less than what should have been paid, the qualification of the annuity payment and the adjustment clause in the GRAT can be disregarded.

This is a different application of the *Atkinson* ruling. The trust in *Atkinson* failed due to shortcomings in the administration of the trust itself, whereas it appears that the trust at issue in the CCA may have failed due to valuation issues.

Under the CCA, it is not clear how much of a deviation in value might be tolerated without undermining the qualification of the trust as a GRAT. This raises considerable uncertainty in apply the CCA to other GRATs, and even how the valuation discussions might impact other valuations and planning outside the GRAT area. If the offers received by Taxpayer in June and September of 2016 had been only 1.5 times rather than almost 3 times the 409A value, would that have been a small enough difference for Chief Counsel to have allowed the GRAT to adjust in accordance with Sect. 2702 and related regulations? Would it have been a sufficient mitigating fact if appraisal had expressly incorporated the fact of the merger negotiations and the June 2016 offers in its analysis (even if it still concluded that the value reflected in the December 2015 409A appraisal was appropriate gift value for the transfer of the shares of stock in Company to the GRAT? Might non-qualification of the GRAT require both a material understatement and bad faith in hiding key factual information? The CCA does not appear to clarify this issue.

This CCA has some troubling implications for the future of GRAT planning, particularly when assets are hard to value. This may have ripple effects beyond merely the creation of GRATs as a wealth transfer device.

Considerations for Practitioners, Following the CCA

While the Chief Counsel appears to have concluded that some of the facts in the CCA are egregious, practitioners should be cautious in delineating which transactions might avoid a similar result (perhaps by being more conservative). Perhaps the CCA signifies that the IRS may endeavor to apply an *Atkinson* analysis whenever the value of a gift to a GRAT is determined for federal gift tax purposes to be greater than the initial valuation. Planners might consider the following:

1. Recommend clients obtain business valuations, particularly for hard-to-value assets like closely-held businesses, which are dated as close as feasible to the actual transfer date, and corroborate any change in circumstances from the date of the appraisal to the date of the transaction.
2. Be certain that gift tax appraisals specifically identify the assets being transferred and reflect consideration of the factors set forth in Revenue Ruling 59-60, as follows:
 - (a) The nature of the business and the history of the enterprise from its inception.
 - (b) The economic outlook in general and the condition and outlook of the specific industry in particular.
 - (c) The book value of the stock and the financial condition of the business.
 - (d) The earning capacity of the company.
 - (e) The dividend-paying capacity.
 - (f) Whether or not the enterprise has goodwill or other intangible value.
 - (g) Sales of the stock and the size of the block of stock to be valued.
 - (h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.^[xvii]
3. Be certain that the appraiser carefully reviews valuations to ensure that they are consistent with current business events and proposed transactions and affirmatively vet them with the client.
4. Name corporate trustees for GRATs, with experience for administering these types of trusts, who will be responsible to ensure that annuity payments are made on time and in the correct amounts. This suggestion does not stem from the issues in the CCA itself, but from the concern that an expanded use by the IRS of the Atkinson attack on GRATs might suggest that the careful, even precise, administration may become even more important. That may be a level of administrative compliance that family (non-professional) trustees may fall short of exceeding.

Implications to Valuations Used in Estate Planning Transactions other than Traditional GRATs

Appraisals should be more careful to address all reasonable facts.

Throughout its opinion, Chief Counsel hammered away at the fact that the prospective transactions had not been disclosed nor incorporated into the analysis supporting the values of the shares of stock transferred to the GRAT. Even if there are □bad facts,□ the CCA suggests that it may be better to address those facts proactively in the valuation.

Had the prospective transaction been disclosed in the appraisal used to support the GRAT gift, perhaps the dynamics of the audit might have resulted in a less extreme holding. The dispute between the IRS and the taxpayer would have been about how the possibility of sale or merger should have been weighted in determining value, rather than a challenge over whether the taxpayer disregarded that key fact.

Fair Market Value Analysis

Taxpayer attempted to use a Sect. 409A appraisal of Company that had been obtained seven months before the transfer to the GRAT to set the gift value for the Company stock.

The Chief Counsel did not specifically indicate that a seven-month-old appraisal could not be used. Rather, the issue that the Chief Counsel had was that there had been intervening activity and potentially preceding facts to the date of valuation, specifically, interested buyers, merger negotiations, and offers to buy, that would affect the value of the shares between the date of the valuation and the date of the transfer.

It appears that no disclosure was made about the intervening activity. The CCA makes clear that the value of the shares of stock in Company transferred to the GRAT had not been adjusted to reflect the merger talk or the offers that had been received, even though the offers were significantly more than the 409A appraisal value.

To determine the value of a gift, □fair market value is the price that a hypothetical willing buyer would pay a hypothetical willing seller, neither being under any compulsion to buy or to sell, and both having **reasonable knowledge of relevant facts**.□^[xvii] Case law provides that the value of property will be a question of fact.^[xviii]

The willing buyer and willing seller are hypothetical persons, rather than specific individuals or entities, and their characteristics are not necessarily

the same as those of the donor and the donee.^[xix] The □hypothetical willing buyer and willing seller are presumed to be dedicated to achieving the maximum economic advantage.□^[xx]

The CCA mentions that the investment brokers were seeking □strategic buyers□ for the shares of stock in Company. Generally, the price that a strategic buyer would pay for assets is believed to not reflect fair market value because the circumstances of the buyer increase the value above what a hypothetical willing buyer would pay for the same asset based on the asset□s intrinsic value. In other words, it would perhaps have been reasonable for Taxpayer to have concluded that the sales prices offered in June of 2016 by the strategic buyers exceeded the □fair market value□ as such term is defined for gift tax purposes when she transferred the shares in July of 2016. While discussing the strategic nature of an offer might have been helpful, practically this may be difficult to do while adhering to standard confidentiality clauses of offers.

That said, the CCA makes abundantly clear that the fair market value standard was not met in the instant case since the hypothetical willing buyer would have been advised about the pending merger, which fact would have been reflected in some manner in the price such a buyer would be willing to pay. The principle that the hypothetical willing buyer and willing seller are presumed to have □reasonable knowledge of relevant facts□ affecting the value of property at issue applies even if the relevant facts at issue were unknown to the actual owner of the property.^[xxi] In addition, by evaluating the actions of the hypothetical buyer and seller, the valuation should presume that each has made a reasonable investigation of the relevant facts.

Chief Counsel likens the case to the 1999 decision by the Ninth Circuit in *Ferguson v. Commissioner*, affirming the Tax Court□s conclusion that a taxpayer could be taxed on gain in appreciated stock that had been transferred to various charitable organizations.^[xxii] The *Ferguson* case was cited by the CCA for its factual similarities, specifically with respect to the targeted search in each case to find merger candidates, the exclusive negotiations with the ultimate buyer, and the generous terms of the merger.

The issue in *Ferguson* was whether the taxpayer□s right to the income from the sale of shares had □ripened□ for tax purposes [in which case] the taxpayer who earned or otherwise created that right, will be taxed on

any gain realized from it, notwithstanding the fact that the taxpayer has transferred the right before actually receiving the income. □ [xxiii]

A complete recitation of the facts of the *Ferguson* case is not provided, but certain dates set forth in the case appeared to have been particularly persuasive to the Ninth Circuit, as summarized in the CCA:

On August 3, 1988, the tender offer was started. On August 15, the taxpayers, with the help of their broker, executed a donation-in-kind record with respect to their intention to donate stock to a charity and two foundations. On September 9, 1988, the charity and the foundations tendered their stock. On September 12, 1988, the final shares were tendered (to the buyer) and on or about October 14, 1988, the merger was completed. [xxiv]

The *Ferguson* court took pains to lay out the specific facts and circumstances that led the Tax Court to agree with the IRS that the merger agreement appeared to be □practically certain□ to go through immediately before the taxpayers transferred their shares to charity. [xxv] In this way, the *Ferguson* decision appeared to have been more than just an assignment of income case in the eyes of Chief Counsel. The CCA rests on the proposition expounded in *Ferguson* that all facts and circumstances surrounding a transaction are relevant to the determination of whether a merger is likely to go through, which, in turn, was relevant to the question of the gift value of the shares of stock transferred to the GRAT in the midst of the merger negotiations.

In the CCA, Chief Counsel suggests that the fact of the ongoing merger negotiations and purchase offers received a few days before the GRAT transfer would have been known to the hypothetical buyer and seller whose actions should be considered in reaching a determination of value. The determination of the share value appears to fail in the CCA because the appraisal did not consider the ongoing merger negotiations, which would have reasonably been considered by the hypothetical buyer and seller in setting the price to be paid for the shares transferred. This is especially true where the company was actively seeking purchasers as opposed to an unsolicited offer.

Decision Tree Analysis

The Chief Counsel expressed that it was particularly concerned that the facts of ongoing negotiations had not been disclosed in the valuation of the shares contributed to the GRAT. What is perhaps not clear is how far such

disclosures should go. Particularly for closely-held business clients, negotiations could occur over many months or even years before finally ending in a sale.

Where a possible buyer expresses interest in purchasing assets but does not commit to a price or memorialize a binding written offer, it may not be clear whether, or to what extent, that such a possibility affect sway the business valuation. Perhaps a decision tree would be helpful for clients who are considering a sale of their business (or any other uncertain event that may be subject to material change) to help identify and quantify potential sale information, using some reasonable estimated probability weights. Such a decision tree analysis may help to quantify the risk associated with offers which may not close and the risk that if no offers close, the company may be worth less than otherwise determined as the best potential buyers have been exhausted and that a sale may take longer than anticipated to perform.

To illustrate this, a decision tree was developed showing each expected outcome of the negotiations underway. Next a value is assigned to the company based upon the value of each expected outcome. A simple decision tree for Company, starting with the December 31, 2015 valuation is shown as Figure 2, reflecting potential risks and outcomes between the current point of knowing interested buyers, and completing a sale.

At each decision point, a probability is assigned representing the likelihood of each potential outcome. These probabilities are determined using the valuation professional's judgment after consultation with management and discussion with the planning team. While these are likely to be very subjective in many situations, it nonetheless might help to demonstrate that all factors were reasonably evaluated when reaching the determination of value of the shares. The total probabilities of each outcome at a node must total 100%. Finally, the total probabilities are multiplied together and then multiplied by the value of that outcome to determine a weighted value for each outcome. These are then totaled to determine the weighted average probabilistic value of the company. See Table 1.

The narrative accompanying the valuation might include, in addition to the decision tree, a narrative providing context and reasons about the assignment of probabilities and values to reflect the nuances of that company as well as the current business environment. These may reflect risks to closing a potential transaction, an analysis of the terms of any offer and the status of that offer, and perhaps other factors. Adjustments will

often be made for the contingencies such as diligence, financing, debt assumption, and regulatory approval representing material risks to completing a transaction and obtaining the offered price.

The decision tree may be useful for identifying, explaining and assessing values of different outcomes in a transactional context, and also for quantifying other uncertainties of business valuation, such as research and development, future capital availability, or pending litigation.

If a decision tree and weighted probability analysis was used to determine the value of the Company at the GRAT funding date under the CCA, the taxpayer may have had a different outcome as important factors impacting the valuation would have been disclosed, discussed, and quantified in the report. However, there is little doubt that a weighted probability analysis would have resulted in a higher value of the shares on the GRAT funding date, reducing the benefits of the GRAT.

On the other hand, perhaps the Taxpayer could have adjusted the 2015 409A valuation by using a Decision Tree analysis, outlining the modifications in full disclosures on a timely filed gift tax return. Even if this resulted in a higher initial contribution to the GRAT, perhaps such an approach could have persuaded the Chief Counsel to conclude in favor of allowing the Taxpayer to adjust the annuity upon final determination of value for gift tax purposes, rather than disqualifying the GRAT entirely.

What to Make of the Fact that the Taxpayer Used a 409A Valuation

The CCA specifically noted that the appraisal had been obtained for 409A purposes and not for gift tax purposes. While the Chief Counsel did not expand on the fact that it was a 409A valuation rather than a gift tax valuation in its analysis in a way that might lead to the conclusion that 409A appraisals should never be used to support a gift value, practitioners should be wary when a client insists on saving transaction costs by repurposing a valuation obtained for 409A purposes to support the value of a gift. Such a decision may prove to be imprudent, particularly in the wake of this CCA. [\[xxvi\]](#)

A Sect. 409A appraisal is obtained by a company in order to set a "strike price" at which options may be paid to employees, contractors, advisors, and others, pursuant to IRC Sect. 409A and related regulations, usually as a form of deferred compensation.

The IRS has explained that for purposes of section 409A, an independent appraisal will be presumed to reflect the fair market value of the stock, so

long as the appraiser is, in fact, independent and the appraisal is dated no more than 12 months before the relevant transaction.^[xxvii] This presumption is rebuttable only if the IRS can show that the valuation is grossly unreasonable. ^[xxviii]

A Sect. 409A appraisal just does not have specific requirements other than that it must be performed by an independent appraiser and be less than twelve months old. A Sect. 409A appraisal is not governed by Rev. Rul. 59-60 nor is it subject to the stringent adequate disclosure requirements. Rather, such an appraisal is presumed to be *per se* valid and sufficient when submitted for Sect. 409A purposes.

On the other hand, a qualified appraisal submitted to support a gift tax value requires that the appraiser be independent but must also lay out very specific items about the transaction, the asset being valued, and the valuation methodology.^[xxix] Even to the extent that the valuation sets forth all of the Rev. Rul. 59-60 factors and otherwise meets all adequate disclosure regulations for transfer tax purposes, the IRS has three (3) years from the date of disclosure to challenge the valuation. Unlike a Sect. 409A appraisal, a valuation submitted for transfer tax purposes will not be deemed presumptively valid just because an independent appraiser prepared it. Rather, a valuation supporting the value of a gift must meet other scrutiny including among other things, satisfying Revenue Ruling 59-60.^[xxx]

None of this is to suggest that a Sect. 409A appraisal could not meet adequate disclosure or pass IRS muster on the audit of a gift or estate tax return, nor is that necessarily what the CCA held.

Where a client insists on using a Sect. 409A appraisal for transfer tax purposes, perhaps the valuation professional might be re-engaged to update the Sect. 409A appraisal with the specific language and data that addresses the nuances of a gift tax fair market value qualified appraisal, and the adequate disclosure rulings and regulations. To the extent that there are significant merger or sale negotiations, apprise the valuation professional of the facts and circumstances so that the appraisal can include a discussion about such negotiations and how they factored into the value of the shares for transfer tax purposes.

In the CCA, the Taxpayer had relied on the earlier 409A valuation to support her GRAT gift but then arranged for a new valuation at a later date. This later valuation evaluated how the ongoing merger negotiations

and offer prices might affect the fair market value, rendering a higher value to support the contribution to a CRT and resulting charitable contribution deduction. These positions (lower value for GRAT, higher value for CRT) were inconsistent and, in both instances that inconsistency favored the taxpayer. That type of action will almost assuredly worsen the IRS's view of the transactions and not be well received by a court should the matter proceed that far.

The valuation used for the CRT substantiated a value that was equal to the offer price, which was about three times the value set forth in the 409A appraisal used to support the GRAT transfer, which occurred five months earlier according to the statement of facts. Practitioners should be cautious of appearances when taking inconsistent positions for similar transactions, particularly when they occur so closely together in time. Perhaps it would have been more persuasive to Chief Counsel if the taxpayer had used the 409A appraisal for both transactions. Alternatively, since the CRT transfer occurred closer to the end of 2016, perhaps the taxpayer could have used the appraisal prepared for 409A purposes for that year, which would avoid the stain of using values that were most advantageous to the taxpayer for different transactions in the same tax year.

Of course, had Taxpayer used either of the relevant 409A appraisals to substantiate the gift to the CRT, her charitable contribution deduction would have been substantially reduced. Returning to the example for illustration purposes:

1. Taxpayer used a valuation as of the date of the CRT transfer to substantiate a transfer of shares of stock in Company worth \$2,850 each. Assuming Taxpayer transferred 100,000 shares, this transfer would have had a value of \$285 million and resulted in a charitable contribution deduction for 2016 of about \$28.5 million.^[xxxii]
2. Had the CRT used the 409A appraisal obtained as of December 31, 2015 to value each share of stock in Company transferred to the CRT at \$1,000 per share in November 2016, her charitable contribution would have been reduced to approximately \$10 million rather than \$28.5 million.^[xxxii]
3. Had the CRT been structured as set forth in the example using the 409A appraisal as of December 31, 2016 to value the shares of stock in Company transferred to the CRT at twice the original 409A appraisal, or \$2,000 for each share, in November 2016, Taxpayer's charitable contribution would have been \$20 million.^[xxxiii]

Effectively, Taxpayer would have lost some of her income tax charitable contribution deduction if she had taken the position of valuing the shares transferred to the CRT that was more consistent with the position that she had taken for her transfers of shares to the GRAT.

The Chief Counsel largely ignored the CRT transaction, making it likely that the CRT valuation adequately supported the charitable contribution and that the CRT actually made the required annuity payments in accordance with the terms of the CRT trust instrument. The CCA appears only to have used the funding of the CRT and the fact that a new valuation was obtained to highlight what the Chief Counsel saw as opportunism by the Taxpayer when it benefited the taxpayer to use a valuation that would take into account all facts and circumstances resulting in a higher value for the shares.. Practitioners should exercise caution when confronted with clients who seek to benefit by taking inconsistent positions for their own advantage.

In practice, these situations may not be as easy to identify as they are often questions of fact and degree. How much time must pass to create sufficient separation between a gift tax value and a later charitable gift value? Time was not the only factor considered by the Chief Counsel in reaching its conclusion, even though the CCA did emphasize the age of the appraisal. Ultimately, it appeared that the government was more concerned that the first appraisal appeared to ignore a material fact (the pending offers). That raises another issue for practitioners: how can practitioners ascertain whether the client has reasonably disclosed all relevant facts to the appraiser, or worse is intentionally obfuscating a material fact? Also, which practitioner would even be involved in this process? In many cases it is only the appraiser who interacts with the client as to valuation matters. In some cases, the client may not be intentionally hiding a fact but may not understand the implications of certain facts. Also, the milestones from a business not considering a sale to a final sale are many and often uncertain. Do mere discussions with a buyer constitute a fact that must be disclosed in order to come to a value of an asset? What about a non-binding letter of intent or non-disclosure agreement to address due diligence? Certainly, a safer approach may be for the client to disclose any possibly relevant information to a qualified, professional appraiser so that the appraiser can reflect the facts in the appraisal report (however they are valued, to deflect any argument that facts were ignored), and then make a professional determination as to which facts to reflect in the appraisal and how.

Implications to GRATs as Defined Valuation Spillover Receptacles

In traditional *Wandry* clauses, the adjustment clause should be structured to leave with the transferor any excess in value of the asset transferred over the stated dollar value of the gift.^[xxxiv] More robust mechanisms that operate so that the entirety of the interests is transferred out of the transferor's hands may be viewed as more secure than *Wandry* approach. These may be structured so that all interests are transferred, with a fixed dollar figure being transferred to an irrevocable completed gift trust, and any excess value spilling over (i.e., as finally determined for federal gift tax purposes), into a non-taxable receptacle, such as a charity, a GRAT, marital trust, or an incomplete gift trust. Essentially, these vehicles are intended to avoid triggering a gift tax to the extent that they are funded if a *Wandry* clause is triggered. Some view these as a safer approach than a *Wandry* mechanism.

Marital trusts raise other issues and may generally be used less frequently. Some advisers have suggested that as compared to an incomplete gift trust a GRAT may be a safer receptacle since GRATs are recognized by regulations. In light of the CCA, practitioners might reconsider the relative risks of each of these techniques. In order for the GRAT in that circumstance to be funded, there would have had to have been a valuation adjustment, suggesting that the IRS will have successfully challenged the original valuation of the assets transferred to the trust.

Does the CCA call this planning into question?

From one perspective if the valuation on the primary transfer does not omit a material fact, perhaps the analysis in the CCA will not apply. However, as explained elsewhere in this article, it is not clear how much deviation in the value of an asset might trigger the harsh consequences in the CCA of completely disqualifying the GRAT.

Further, the CCA holding relied fairly heavily on the Tax Court's holding in *Atkinson* which was based on the fact that the taxpayer did not actually receive the annuities that were owed to her. To the extent that a GRAT is used as the non-taxable receptacle for a *Wandry* clause, annuity payments could not be paid on the spillover amount until after the gift tax value is finally determined which could be years into the future. By way of illustration, consider that a client transferred \$10 million worth of shares in a closely-held business and that, based on the initial valuation, the client believes that 45% of the entity was worth \$10 million. The adjustment mechanism might operate to have any excess value deemed transferred to

a zeroed-out GRAT as of the date of the original transfer. If the value as finally determined for federal gift tax purposes of 45% of the entity was \$12 million, \$2 million would have funded the GRAT.

Under the terms of the GRAT, annuity payments would be due from the GRAT to the grantor-annuitant on an annual basis for the duration of the GRAT-term. However, the process of finally determining a value for gift tax purposes takes time and it can be quite likely that two or more annuity payments might be missed by the time that process has wound up, by, for example, a completion of a gift tax audit. The CCA may offer the IRS another avenue for attack based on the failure of annuity payments.

Some practitioners suggest funding the GRAT with assets apart from the assets to be received on a valuation adjustment so that the GRAT can be reflected on a gift tax return in the year of transfer to begin tolling the statute of limitations and to assure that the GRAT is functioning in years prior to a valuation adjustment for gift tax value as finally determined.^[xxxvi] It is not clear that this type of additional funding would avoid a challenge based on the CCA since the annuities would not initially include any amounts from the spillover adjustment.

In other cases, transfers might be based on a □two-tiered *Wandry*□ arrangement consisting of a traditional *Wandry* transfer followed by the simultaneous sale of any shares (or other assets) left by the *Wandry* adjustment clause if the clause is triggered. In other words, the transferor makes a gift of a specified value of the shares of the entity, believing that all of the transferor□s interest in the entity is equal to the value being transferred. In the event that there is some excess value once the value of the shares is finally determined for federal gift tax purposes, the second tier of the *Wandry* arrangement could consist of a second sale of any shares, effective as of the same date as the primary *Wandry* sale. The price for this second sale, if any, would be for a price equal to the gift tax value as finally determined. The sale would be supported by a note upon which interest accrues from closing and is required to be made current within a specified time period, e.g., 90-days of the final determination. Further, the sale would ordinarily be made to a grantor trust so that there would not be any income tax consequences.

Practitioners might also consider the implications for these so-called two-tiered *Wandry* arrangements that use sales to grantor trusts as the non-taxable receptacle in the wake of the CCA. Perhaps the Note that undergirds the transaction should provide for accumulating interest and principal for the first five years following the initial transaction so that there

is sufficient time for the gift tax return disclosing the transaction to wind its way through the audit process. On the one hand, this might strengthen the transaction against a CCA-type challenge. On the other hand, the practitioner may wish to evaluate the Note to confirm that it has independent economic substance and is fairly drafted not just from the perspective of the client-seller but also from the trust-purchaser's point of view.

Does the CCA Create Possible Issues for a *Wandry* Clause?

In recent years, planning practitioners have increasingly used valuation adjustment clauses to minimize the potential gift tax risk of a valuation adjustment on audit. This has been particularly true in years when clients look to make last-minute transfers when it may not be possible to obtain a completed valuation in advance.

Defined value mechanisms were upheld by the Tax Court in its *Wandry*^[xxxvii] decision but the IRS appealed the decision and ultimately issued a statement that the commissioner did not acquiesce to the Court's conclusion. The Service has made its intention to contest *Wandry*, especially if taxpayers deviate in any way from the specific language upheld by the Tax Court.

It is unclear whether the CCA has any implications for practitioners using *Wandry* clauses, particularly where the valuation used to support the transaction is deemed to be deficient in some way. There is a distinct difference between a *Wandry* valuation adjustment mechanism and a GRAT which requires a qualified annuity. The fault the Chief Counsel identified was based almost entirely on the initial valuation of the assets that were contributed to it. Because the annuity amounts were based on the initial valuation, the CCA reasoned, the annuity was not being paid in the correct amount. Indeed, the facts of the CCA suggest that the GRAT itself included all of the correct language and appeared to have been administered properly in accordance with its terms.

On the other hand, *Wandry* adjustment mechanisms would operate differently. By way of example, assume that a *Wandry* clause called for a transfer of a fixed dollar amount of interests e.g., \$10 million worth of LLC membership interests rather than a transfer defined in terms of a percentage of the LLC membership interests, e.g., 45% of the membership interests of an LLC. If, in that case, the transferor used a valuation that omitted a material fact, similar to the CCA, perhaps the IRS might use such

an omission to challenge the effectiveness of the *Wandry* adjustment mechanism and seek to invalidate it, under the valuation reasoning (not the technical issues pertaining to the GRAT) set forth in the CCA, arguably resulting in the transfer of the percentage interest rather than the value.

To the extent that the *Wandry* mechanism is successfully challenged by the IRS, the taxpayer might not be deemed to have transferred interests with a value of \$10 million but rather could be stuck with the implications of having made a gift of 45% of the LLC at issue. Given that the IRS has already openly expressed its displeasure with the *Wandry* ruling coupled with the CCA's conclusion that a material omission of facts in a valuation undermines the transaction involved, it is conceivable that, at some point, the IRS could use its reasoning in the to threaten planning with *Wandry* adjustment clauses if there is a similarly material and intentional omission of a fact from the valuation.

All of that said, GRAT valuation adjustments based on a percentage of the value of the property is supported by regulations, which arguably should make them more insulated from an IRS challenge whereas *Wandry* adjustment mechanisms are based on a court case to which the IRS non-acquiesced, perhaps making that approach less secure than a GRATs.

It would seem that a practitioner may be able to buttress *Wandry* adjustment mechanisms against a challenge based on the CCA by encouraging clients to obtain a proper valuation supporting the value. It seems counter-intuitive to focus on the strength of a valuation since the primary purpose of *Wandry* is to allow the transferor to adjust once values can be finally determined for federal gift tax purposes. Unfortunately, it seems that the CCA holding may necessitate additional protections that might be afforded by obtaining a valuation that is harder for the IRS to challenge.

Collaboration Across Disciplines is Key for Successful Estate Plans

The implications of this CCA underscore the importance of collaborating across disciplines. Throughout the timeline of events described by Chief Counsel, it is quite likely that Taxpayer and Company might have been advised by professionals with different specialties, and different scopes of engagement which perhaps did not expand beyond each professional's silo, as follows:

Valuation professionals: Under the facts of the CCA, Company was valued for 409A purposes in three different years, e.g. December 2015, December 2016, and December 2017. Additionally, a valuation was procured to

support Taxpayer's transfer of shares of stock in Company in November of 2016 to a charitable remainder trust. The facts do not clarify whether a different valuation professional was used for each different valuation or each different type of valuation. Had different appraisers been used, perhaps they should have been permitted to communicate in order to avoid inconsistencies in the approach.

Investment bankers: Taxpayer and/or Company hired investment bankers in early 2016 to find strategic buyers. These solicitations likely included statements regarding the value of the company which could impact not only an appraisal, but also provide ammunition for the service in attacking a valuation. Therefore, the Investment Bankers should share this information with the valuation professionals and discuss what confidentiality protections would be appropriate. Investment bankers are well aware of the importance of tax planning prior to a liquidation or other event and often refer their clients to CPAs for income tax planning and estate planners for estate planning. Why was there no communication in the instant case by the investment bankers to estate planning counsel?

Corporate counsel: The price of the shares of stock in Company changed over the course of the negotiations and it appears that the merger was structured to occur over time. It is unlikely that this was done without advice and coordination by corporate counsel. Therefore, corporate counsel input should be included with the planning team. Corporate counsel should be in communication with the appraiser and estate planning counsel.

Estate planning counsel: Taxpayer transferred shares of stock in Company to a grantor-retained annuity trust on July 3, 2016 and a charitable remainder trust in November of 2016. Were both of these transactions structured with the advice and coordination by an estate planning counsel? Did estate planning counsel identify and caution the client about the inconsistent positions? Who was involved?

Certified Public Accountant/Tax Preparer: Company and Taxpayer would have had significant required tax filings to make as part of these transactions.

It is unclear whether the professionals involved with the taxpayer were coordinated and collaborating with one another. Too often clients intentionally restrict or prevent collaboration with advisers to save fees, or perhaps to obfuscate facts that might concern one or another of their advisers if in fact communications were open. The CCA appears to

suggest possible gaps in communications between various professionals who likely would have been engaged by the taxpayer.

By way of example, while it is likely that the investment banker coordinated with corporate counsel, it would have been advantageous to Taxpayer if the investment banker also communicated with the estate planning attorney and valuation expert about the status of negotiations with the potential buyers.

It is often advantageous for estate tax planners and valuation professionals to work with corporate counsel, to understand whether the shares being transferred are subject to any restrictions that might result in a reduction in the gross value of the shares. Perhaps corporate counsel could have helped to recapitalize Company so that Taxpayer had shares of nonvoting, unmarketable stock in the entity to transfer to the GRAT.

Additionally, though not explicitly stated in the CCA, it is implicit that Company and Taxpayer would have had to have made certain disclosures to the Internal Revenue Service relative to these transactions on various tax returns that would have been filed. Had the tax preparer been consulted and collaborating with the planning team, there may have been other opportunities to address the defalcations in the planning identified by Chief Counsel. By way of example:

Taxpayer, should have filed a 2016 Form 709 (gift tax return), in order to disclose the gifts that she made to the GRAT and to the CRT, along with any other gifts that she made in 2016.^[xxxviii] The preparer of the gift tax return would have likely requested copies of the following documentation to support the transfers that needed to be disclosed on the 2016 gift tax return for Taxpayer:

For the GRAT gift: 1. The GRAT instrument; 2. The Assignment of Company shares to the GRAT; 3. The GRAT calculations; 4. An appraisal of the shares of stock transferred to the GRAT; and 5. The basis of the shares of stock transferred to the GRAT. An amended and restated Shareholders' Agreement reflecting the GRAT as an owner of shares. If an institutional trustee were named a direction letter directing the institutional trustee to accept and hold the shares.

For the CRT transfer: 1. The CRT instrument; 2. The assignment of Company shares to the CRT; 3. The CRT calculations; 4. The appraisal of the shares of stock transferred to the CRT; and 5. The basis of the shares of stock transferred to the CRT. An amended and restated Shareholders' Agreement reflecting the CRT as an owner

of shares. If an institutional trustee were named a direction letter directing the institutional trustee to accept and hold the shares.

Any other charitable or non-charitable gifts made during the tax year.

Perhaps the gift tax return preparer could have alerted the estate planning attorney about the valuation issue, which should have been obvious to the preparer upon receipt of two different appraisals for shares of stock in the same entity. The estate planning attorney may have then reached out to the 409A appraisal professional to request an updated valuation, considering the information that existed as of the date of the GRAT transfer. The estate planning attorney could contact the Trustee to ensure that the annuity payments were adjusted to account for the new valuation. All of this could have been disclosed on a timely filed gift tax return in October of 2017.

Conclusion

Practitioners should consider that the implications of the CCA could be broader than merely funding GRATs with a proper valuation. The lessons of the CCA concerning disclosure of relevant facts in all estate planning transactions. The strict application of the *Atkinson* case in the CCA suggests that practitioners should expect application of those principals to GRATs in other circumstances: CRTs, GRATs, and defined value mechanisms. Practitioners may wish to consider alternatives to using GRATs as spillover receptacles in a defined value mechanism whereas in the past the practitioner might have felt more comfortable using the GRAT in that context.

Going forward, planners could endeavor to manage the risk posed by the CCA by using proper valuations and by encouraging clients to disclose all relevant facts and take consistent positions on similar transactions. Planners should educate clients as to the importance of communication among all advisers. Collaboration is key to creating better estate plans.

In the end, the experience of the hypothetical Taxpayer and her planning may be a cautionary tale for planning professionals across all disciplines. By not fostering collaboration among her advisors, Taxpayer's estate plan might have been jeopardized by Chief Counsel who took the harsh position of invalidating a GRAT in its entirety, rather than allow an adjustment to the GRAT annuity payments.

Figure 1. Fictional timeline for illustration purposes, based on facts set forth in the CCA.



Figure 2. Possible Decision Tree, using fictional values based upon the CCA Facts

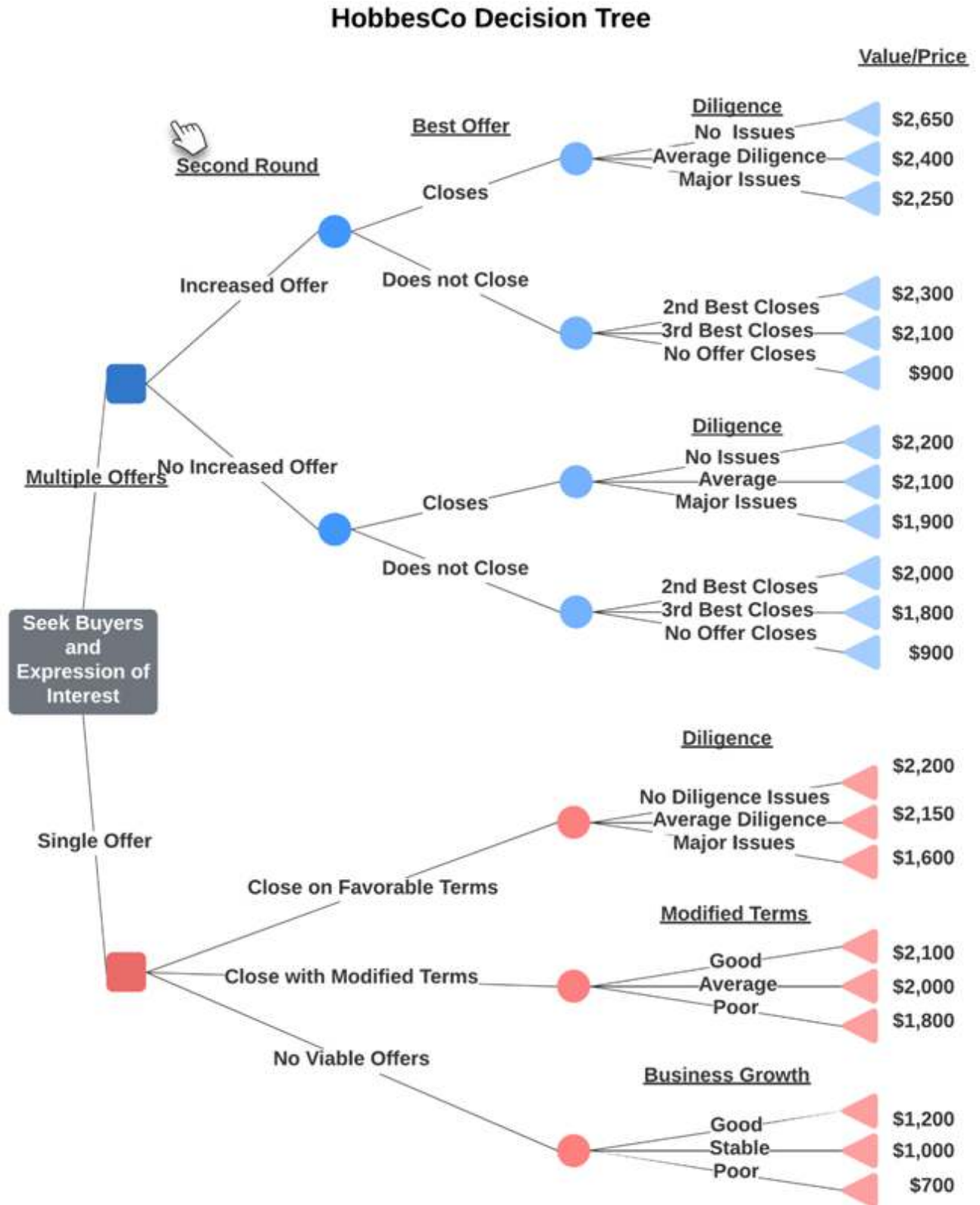


Figure 3. Probability weighting to illustrate how a value might be determined using the Decision Tree analysis.

Offers	Second Round	Top Offer Closes	Diligence	Probability	Value	Weighted Value	
Multiple 75%	Increased Offer 75%	Close 75%	No issues 15%	6.33%	2,650	167.70	
			Average 60%	25.31%	2,400	607.50	
			Major 25%	10.55%	2,250	237.30	
		No Close 25%	Other Offers				
			2nd 50%	7.03%	2,300	161.72	
			3rd 30%	4.22%	2,100	88.59	
	None 20%	2.81%	900	25.31			
	No Increased Offer 25%	Close 70%	No issues 15%	1.97%	2,200	43.31	
			Average 60%	7.88%	2,100	165.38	
			Major 25%	3.28%	1,900	62.34	
		No Close 30%	Other Offers				
			2nd 50%	2.81%	2,000	56.25	
3rd 30%			1.69%	1,800	30.38		
No close 20%	1.13%	900	10.13				
Single 25%	Terms		Diligence				
			No issues 15%	2.44%	2,200	53.63	
			Average 60%	9.75%	2,150	209.63	
			Major Issues 25%	4.06%	1,600	65.00	
			Terms				
			Good 25%	1.56%	2,100	32.81	
	Average 50%	3.13%	2,000	62.50			
	Poor 25%	1.56%	1,800	28.13			
	No Offer Clc 10%		Growth				
			Good 40%	1.00%	1,200	12.00	
			Stable 30%	0.75%	900	6.75	
	Poor 30%	0.75%	600	4.50			
				100.00%		\$2,131 Weighted Average Probabalistic Value	

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Ashley Case
 Joy Matak
 Matthew Rak

Martin M. Shenkman

CITE AS:

LISI Estate Planning Newsletter #2940 (March 1, 2022) at <http://www.leimbergservices.com>. Copyright 2022 Leimberg Information Services, Inc. (**LISI**). Reproduction in Any Form or Forwarding to Any Person Prohibited - Without Express Permission. This newsletter is designed to provide accurate and authoritative information regarding the subject matter covered. It is provided with the understanding that **LISI** is not engaged in rendering legal, accounting, or other professional advice or services. If such advice is required, the services of a competent professional should be sought. Statements of fact or opinion are the responsibility of the authors and do not represent an opinion on the part of the officers or staff of **LISI**.

CITATIONS:

^[i] Internal Revenue Code Sect. 6110(i)(1)(A).

^[ii] A grantor retained annuity trust (a "GRAT") is a trust where the donor conveys assets to a trust, retaining an annuity during the GRAT term. Section 2702 values the transfer for gift tax purposes as the net amount of the amount transferred less the present value of the annuity payments. By retaining an annuity with a present value equal to the value of the initial gift, the value for gift tax purposes can be reduced to zero. This is the so-called "zeroed out GRAT." Some practitioners prefer a nominal gift with a small amount of value believing that having a small gift to report on the gift tax return bolsters the GRAT as reported on the gift tax return. The net effect of an effectively structured GRAT should be to limit the estate tax value of the transferred assets in the donor's estate to the annuity payment received by the donor under the terms of the GRAT instrument, inclusive of an interest rate equivalent to 120% of the Applicable Federal Rate. For reference purposes, the January 2022 rate was 1.6%.

[\[iii\]](#) Internal Revenue Code Sect. 6110(i)(1)(A).

[\[iv\]](#) All dates are fictitious and provided for illustration purposes only.

[\[v\]](#) A "strategic buyer" often refers to a purchaser who has a unique motivation to acquire the target company, which would result in that buyer paying a premium above fair market value. An example might be a competitor with a foothold in a target market of purchaser or a target company owning intellectual property of unique value to the purchaser's operations.

[\[vi\]](#) This was quoted by the CCA, but the source is not mentioned.

[\[vii\]](#) Projected GRAT Calculations pursuant to IRC Sect. 2702, and related regulations, for illustration purposes only, confirmed using Leimberg Information Services, Inc. NumberCruncher software.

[\[viii\]](#) Projected CRT Calculations pursuant to IRC Sect. 664(d)(1), and related regulations, for illustration purposes only, confirmed using Leimberg Information Services, Inc. NumberCruncher software.

[\[ix\]](#) It appears from the facts set forth in the CCA that the merger agreement likely included call rights by the purchaser to complete the acquisition over several years.

[\[x\]](#) Projected GRAT Calculations pursuant to IRC Sect. 2702, and related regulations, for illustration purposes only, confirmed using Leimberg Information Services, Inc. NumberCruncher software.

[\[xi\]](#) CCA, referring to IRC Sect. 2702 and Treas. Reg. Sect. 25.2702-3(b)(1)(ii)(B). (Emphasis added).

[\[xii\]](#) Calculations provided for illustration purposes only, as confirmed using Leimberg Information Services, Inc. NumberCruncher software. Query whether the GRAT would still owe the annuity to Taxpayer even though it was not a "qualified annuity interest" for the purposes of IRC Sect. 2702. It would seem that the trust would owe this annuity back to the Taxpayer. A discussion of the practical and tax effect of this apparent result is beyond the scope of this article but does raise some interesting questions about the extent of the Chief Counsel's conclusion in the within matter.

[xiii] See *Atkinson v. Commissioner*, 115 T.C. 26, 32 (2000), *aff'd*, 309 F.3d 1290 (11th Cir. 2002).

[xiv] *Id.* at 27.

[xv] *Id.* at 30-31. (Emphasis added).

[xvi] Rev. Rul. 59-60, 1959-1 CB 237, 238-239, as modified and amplified by subsequent Revenue rulings and case law.

[xvii] Treas. Reg. Sect. 25.2512-1; Rev. Rul. 59-60, 1959-1 C.B. 237. (Emphasis added.)

[xviii] See *Estate of Simplot v. Commissioner*, 112 T.C. 130 (1999); *Redstone v. Commissioner*, T.C. Memo. 2015-237.

[xix] See *Estate of McCord v. Commissioner*, 120 T.C. 358 (2003), *rev'd* on other grounds, 461 F.3d 614 (5th Cir. 2006).

[xx] *Estate of Newhouse v. Commissioner*, 94 T.C. 193, 218 (1990).

[xxi] *Estate of Kollsman v. Commissioner*, T.C. Memo. 2017-40, *aff'd*, 777 Fed. Appx. 870 (9th Cir. 2019).

[xxii] See *Ferguson v. Commissioner*, 83 AFTR 2d 99-1775 (174 F.3d 997 (9th Cir. 1999)).

[xxiii] *Ferguson* at 99-1780, *supra* note xxii. (Emphasis in original.)

[xxiv] The CCA, summarizing the facts of *Ferguson*, *supra* note xxii.

[xxv] *Ferguson* at 99-1781.

[xxvi] While not specifically stated in the CCA, query whether the administration of the GRAT and the valuations were held to a higher standard due to the magnitude of the transfers involved.

[xxvii] See Rev. Proc. 2007-31 III. D. 4.c.ii.

[xxviii] Treas. Reg. Sect. 1.409A-1(b)(5)(iv)(B)(2)(i).

[xxix] See Treas. Reg. Sec. 301-6501(c)-1 *et. seq.*

[\[xxx\]](#) See note xvi and related discussion, *supra*.

[\[xxxii\]](#) Calculations provided for illustration purposes only, as confirmed using Leimberg Information Services, Inc. NumberCruncher software, based on the following assumptions: Daphne set up a 20-year normal CRUT with an optimized payout at the November 2016 Sect. 7520 Rate of 1.60%.

[\[xxxiii\]](#) Calculations provided for illustration purposes only, confirmed using Leimberg Information Services, Inc. NumberCruncher software with the same factors as set forth in note xxxi, *supra*, other than the FMV of the trust which was changed from \$11.25 million to \$3.75 million.

[\[xxxiiii\]](#) Calculations provided for illustration purposes only, confirmed using Leimberg Information Services, Inc. NumberCruncher software with the same factors as set forth in note xxxi, *supra*, other than the FMV of the trust which was changed from \$11.25 million to \$7.5 million.

[\[xxxiv\]](#) See *id.*, generally.

[\[xxxv\]](#) There are practitioners who disclose the potential transfer to a GRAT receptacle on the timely filed gift tax return, even if no other transfers are actually made to the GRAT. Practitioners may want to consider whether this is a safer practice.

[\[xxxvi\]](#) *Wandry, et al. v. Comm'r*, TC Memo 2012-88. See also *Nelson v. Commission*, T.C. Memo 2020-81.

[\[xxxvii\]](#) This return would have been due on April 18, 2017 with an automatic extension available through October 16, 2017.