NEW YORK STATE BAR ASSOCIATION
One Elk Street, Albany, New York 12207 PH 518.463.3200 www.nysba.org

TAX SECTION

2022-2023 Executive Committee

ROBERT CASSANOS
Chair
Fried, Frank, Harris, Shriver & Jacobson LLP
One New York Plaza
New York, NY 10004-1980
212/859-8278
PHILIP WAGMAN
First Vice-Chair
212/878-3133
JIYEON LEE-LIM
Second Vice-Chair
212/906-1298
ANDREW R. WALKER
Secretary
212/530-5624
COMMITTEE CHAIRS:
Attributes
Andrew Herman
Gary R. Scanlon
Bankruptcy and Operating Losses
Brian Krause
Stuart J. Goldring
Compliance, Practice & Procedure
Megan L. Brackney
Elliot Pisem
Consolidated Returns
William Alexander
Shane J. Kiggen
Corporations
Daniel Z. Altman
Michael T. Mollerus
Cross-Border Capital Markets
Craig M. Horowitz
Eschi Rahimi-Laridjani
Cross-Border M&A
Adam Kool
Ansgar A. Simon
Debt-Financing and Securitization
John T. Lutz
Michael B. Shulman
Estates and Trusts
Austin Bramwell
Alan S. Halperin
Financial Instruments
Lucy W. Farr
Jeffrey Maddrey
"Inbound" U.S. Activities of Foreign Taxpayers
Peter J. Connors
S. Eric Wang
Individuals
Martin T. Hamilton
Brian C. Skarlatos
Investment Funds
James R. Brown
Pamela L. Endreny
New York City Taxes
Alysse McLoughlin
Irwin M. Slomka
New York State Taxes
Paul R. Comeau
Jack Trachtenberg
"Outbound" Foreign Activities of U.S. Taxpayers
William A. Curran
Kara L. Mungovan
Partnerships
Meyer H. Fedida
Amanda H. Nussbaum
Pass-Through Entities
Edward E. Gonzalez
David W. Mayo
Real Property
Marcy Geller
Jonathan R. Talansky
Reorganizations
Lawrence M. Garrett
Joshua M. Holmes
Spin-Offs
Tijana J. Dvornic
Peter A. Furci
Tax Exempt Entities
Dahlia B. Doumar
Stuart Rosow
Taxable Acquisitions
Richard M. Nugent
Sara B. Zablotney
Treaties and Intergovernmental Agreements
David R. Hardy
William L. McRae

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE:

Lee E. Allison
Jennifer Alexander
Erin Cleary
Yvonne R. Cort
Steven A. Dean
Jason R. Factor
Rose Jenkins
Vadim Mahmoudov
Yaron Z. Reich
David M. Rievman
Peter F. G. Schuur
Mark Schwed
Stephen E. Shay
Patrick E. Sigmon
Eric B. Sloan
Andrew P. Solomon
Linda Z. Swartz
Jennifer S. White
Libin Zhang

Report No. 1464
July 12, 2022

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William M. Paul
Principal Deputy Chief Counsel
and Deputy Chief Counsel
(Technical)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report No. 1464 - Report on the Proposed Section 2010 Regulations Defining Exceptions to the Anti-Clawback Rule.

Dear Ms. Batchelder and Messrs. Rettig and Paul:

I am pleased to submit Report No. 1464 of the Tax Section of the New York State Bar Association discussing the proposed Section 2010 regulations defining exceptions to the anti-clawback rule.

We appreciate your consideration of our Report. If you have any questions, please feel free to contact us and we would be happy to assist.

Respectfully Submitted,

Robert Cassanos
Chair

Enclosure

FORMER CHAIRS OF SECTION:

Peter L. Faber
Alfred D. Youngwood
David Sachs
J. Roger Mentz
Willard B. Taylor
Herbert L. Camp
James M. Peaslee
Peter C. Canellos
Michael L. Schler
Carolyn Joy Lee
Richard L. Reinhold
Steven C. Todrys
Harold R. Handler
Robert H. Scarborough
Samuel J. Dimon
Andrew N. Berg
Lewis R. Steinberg
David P. Hariton
Kimberly S. Blanchard
Patrick C. Gallagher
David S. Miller
Erika W. Nijenhuis
Peter H. Blessing
Jodi J. Schwartz
Andrew W. Needham
Diana L. Wollman
David H. Schnabel
Stephen B. Land
Michael S. Farber
Karen Gilbreath Sowell
Deborah L. Paul
Andrew H. Braiterman
Gordon E. Warnke

CC:

Thomas C. West, Jr.
Deputy Assistant Secretary
Department of the Treasury

Krishna Vallabhaneni
Tax Legislative Counsel
Department of the Treasury

Catherine Hughes
Attorney Advisor
Department of the Treasury

John D. MacEachen
Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service

Report No. 1464

New York State Bar Association Tax Section

REPORT ON THE PROPOSED SECTION 2010 REGULATIONS DEFINING EXCEPTIONS TO THE ANTI-CLAWBACK RULE

July 12, 2022

TABLE OF CONTENTS

I. SUMMARY OF PRINCIPAL RECOMMENDATIONS 2

II. EFFECT OF TARGETED GIFTS ON THE USE OF DSUE AND STANDARD BEA 3

III. DEFINING THE CATEGORIES OF TARGETED GIFTS 8

IV. TREATMENT OF QUALIFIED PAYMENT RIGHTS 9

V. EXCEPTION TO THE DEFINITION OF TARGETED GIFTS 11

VI. POTENTIAL DISPARITIES CREATED BY THE 18-MONTH RULE 14

APPENDIX 17

New York State Bar Association Tax Section

Report on the Proposed Section 2010 Regulations Defining Exceptions to the Anti-Clawback Rule

This Report (the "Report")[1] provides comments on proposed regulations (the "Proposed Regulations")[2] issued April 27, 2022 pursuant to the authority of Section 2001(g)(2) of the Internal Revenue Code of 1986, as amended (the "Code").[3] In 2017, the Tax Cuts and Jobs Act[4] amended Section 2010(c) in order to increase temporarily the basic exclusion amount (the "BEA") that is allowed in the computation of estate and gift taxes. The increased BEA is available to estates of decedents dying after December 31, 2017, and before January 1, 2026; by Section 2505(a)(1), it is also available for gift tax purposes during the same period.[5] At the same time as the BEA was increased, the Tax Cuts and Jobs Act added Section 2001(g)(2), which directs the Secretary of the Treasury Department ("Treasury") to issue regulations necessary or appropriate to carry out Section 2001 with respect to changes in the BEA.[6]

On November 26, 2019, the Treasury and the Internal Revenue Service (the "Service") issued final regulations generally providing that an estate is entitled to the greater of the BEA available at death or the BEA used by the decedent during his or her lifetime.[7] The purpose of this rule, known as the "anti-clawback rule," is to prevent a tax from being imposed at death on transfers that, during the decedent's lifetime, were shielded from gift tax by the higher BEA.[8] At the same time, in response to a comment made in our Report No. 1410, dated

[1] The principal authors of this Report are Austin Bramwell and Alan S. Halperin. Substantial contributions were made by Amy Albert, Bonnie J. Daniels, Stuart Gross, and Renee Stern. Helpful comments were received from Robert Cassanos, Rose Jenkins, Stephen Land, Michael Schler, and Philip Wagman. This Report reflects solely the views of the Tax Section of the New York State Bar Association ("NYSBA") and not those of the NYSBA Executive Committee or the House of Delegates.

[2] REG-118913-21(April 27, 2022).

[3] Unless otherwise indicated, all references herein to a "Section" shall refer to a particular section of the Code. The Code is also sometimes referred to herein as the "IRC."

[4] Pub. L. 115-97 (2017). Although popularly known as the "Tax Cuts and Jobs Act," that name does not appear in the legislation as enacted.

[5] Pub. L. 115-97 § 11061(a).

[6] Pub. L. 115-97 § 11061(b).

[7] 84 Fed. Reg. 64995 (Nov. 26, 2019).

[8] Under the estate tax computation procedures, gifts during lifetime are added back into the estate tax base, either because they are included in the gross estate under one of the gross estate inclusion "string" Sections of the Code or as "adjusted taxable gifts" under Section 2001(b)(1)(B). At the same time, the applicable exclusion amount that was used during lifetime is technically restored at death under Section 2010; thus, the effect of adding gifts into the estate tax base is to use up a portion or all of the applicable exclusion amount available at death. (If the decedent's gifts exceeded the applicable exclusion amount in a given year, Section 2001(b)(2) provides the equivalent of a credit for the gift tax that was payable.) However, if the applicable exclusion amount declines, then, without a special anti-clawback rule to the contrary, the estate

February 20, 2019 (our "Prior Report"), the Treasury and the Service reserved space for what the preamble of the final regulations described as "an anti-abuse provision." The Proposed Regulations contain the proposed text of that provision. In general, in the words of the Proposed Regulations' preamble, the proposed anti-abuse provision is designed to deny the benefit of the increased BEA "in circumstances where the donor continues to have the title, possession, use, benefit, control, or enjoyment of the transferred property during life."

We thank the Treasury and the Service for their thoughtful consideration of our earlier comments. While we generally support the approach taken in the Proposed Regulations, we believe that it can be improved in some respects, as described in this Report. In the discussion that follows, we refer to the temporarily increased BEA as the "bonus BEA." We refer to the BEA that remains available to an estate after the bonus BEA expires (or is sooner reduced by Congress) as the "standard BEA." Finally, we refer to transfers that fail to preserve the bonus BEA as "targeted gifts."

I. SUMMARY OF PRINCIPAL RECOMMENDATIONS

We recommend the following:

1. Treasury and the Service consider whether the portability regulations should be revised so that targeted gifts may not be used to lock in deceased spousal unused exclusion ("DSUE") before an individual remarries and survives a second spouse.

2. The final regulations clarify whether a targeted gift can absorb the standard BEA, even if it cannot preserve bonus BEA.

3. The final regulations clarify that some transfers are treated as targeted gifts, even if they are neither includible in the gross estate nor treated as includible.

4. Treasury and the Service consider whether gifts that the donor later borrows back should, in some cases, be treated as targeted gifts.

5. The final regulations clarify that the retention of a qualified payment right within the meaning of Section 2701(c)(3) does not cause a transfer to be treated as a targeted gift.

6. The final regulations replace or supplement the 5% rule set forth in Prop. Reg. § 20.2010-1(c)(ii)(A) with a provision that that would permit application of the anti-clawback rule in cases where the donor retains no more than a qualified retained interest within the meaning of Section 2702(b).

tax computation procedures would cause an estate tax at death on gifts that were shielded by the higher applicable exclusion amount available during lifetime.

7. The final regulations eliminate the disparities that would arise under the Proposed Regulations in the treatment of transfers, relinquishments, or eliminations of interests, powers or property prior to death, and instead adopt a uniform and consistent rule.

II. EFFECT OF TARGETED GIFTS ON THE USE OF DSUE AND STANDARD BEA

The final anti-clawback rule contains two ordering principles, which together determine how much bonus BEA, if any, remains available at death.[9] First, if an individual inherits deceased spousal unused exclusion or "DSUE" from a deceased spouse under the portability rules of Section 2010(c),[10] then the DSUE is deemed to be applied before any BEA.[11] Thus, an individual must exhaust any DSUE before any BEA (whether bonus BEA or standard BEA) can be used. Second, the BEA at death is only enhanced if the BEA applied against a decedent's taxable gifts exceeds the standard BEA.[12] For example, if a decedent made no more than a $6.8 million taxable gift when the BEA was $11.4 million, and later dies in a year when the BEA is $6.8 million, only $6.8 million of BEA is available at death. The $6.8 million of BEA shields the lifetime gift from estate tax but does not shield any portion of the taxable estate passing at death. The $4.6 million difference between the $11.4 million of BEA available when the gift was made and the $6.8 million gift amount is lost. Effectively, the standard BEA is applied before any bonus BEA can be preserved.

Given the foregoing two ordering principles, any anti-abuse rule should include guidance on what portion, if any, of a decedent's total applicable exclusion amount may be used by targeted gifts. As discussed below, the Proposed Regulations take a different approach to targeted gifts that, for gift tax purposes, use up DSUE versus targeted gifts that use up standard BEA. We recommend that Treasury and the Service either adopt a consistent approach or, if the disparity is retained in the final regulations, explain the rationale for the difference in treatment.

Effect of targeted gifts on DSUE. The Proposed Regulations directly address, in an example, whether a targeted gift may use up any DSUE inherited by the donor from a deceased spouse. Specifically, in Example 3 of the Proposed Regulations, a decedent who had inherited $2 million of DSUE made a $2 million taxable gift in the form of a promise that was enforceable under state law. The decedent also made a $9 million gift of cash (presumably,

[9] These ordering principles are discussed in detail in the preamble to the final regulations. *See* 84 Fed. Reg. 64,996.

[10] In general, the portability provisions allow a surviving spouse to inherit and use as his or her own the unused exclusion of the deceased spouse. A decedent's total "applicable exclusion amount" comprises the BEA plus any DSUE. IRC § 2010(c)(2).

[11] Treas. Reg. § 20.2010-1(c)(1)(ii)(A).

[12] Treas. Reg. § 20.2010-1(c).

without retaining an interest[13]) a "few days later." [14] Although both gifts were made when the bonus BEA was $11.4 million, the decedent dies in a year when the BEA is $6.8 million. The example concludes that the enforceable promise gift successfully absorbed all of the decedent's $2 million of DSUE, so that the later cash gift preserves $9 million of BEA in the computation in the estate tax. In other words, a targeted gift – such as a gift of an enforceable promise[15] – can use up DSUE even though it cannot use up any BEA.

Conceptually, Example 3 takes the same approach to clawback that Treasury and the Service previously adopted in implementing the portability regime of Section 2010(c). As noted in our Prior Report, because a donor may only use DSUE inherited from his or her "last deceased spouse," a donor's estate could, without a special rule to the contrary, be deprived of DSUE that the donor had used up prior to remarrying and surviving a second spouse. Treas. Reg. § 20.2010-3(b) prevents this result by adding to the applicable exclusion amount available at death any DSUE that was actually used by a decedent prior to surviving a second spouse.

In other words, the portability regulations have their own anti-clawback rule (referred to herein as the "portability anti-clawback rule"), which addresses the effect of gifts that use up DSUE before it is lost upon remarriage and survival of a second spouse. The portability anti-clawback rule – which is not to be confused with the anti-clawback rule of Treas. Reg. § 20.2010-1(c) that deals with the effects of declines in the BEA – does not distinguish between targeted and non-targeted gifts. Thus, any form of taxable gift, including a gift of an enforceable promise, can successfully preserve DSUE before it is lost following the remarriage and survival of a second spouse.

Example 3 of the Proposed Regulations applies the approach of the portability anti-clawback rule to the anti-clawback rule of Treas. Reg. § 20.2010-1(c). That is, just as a targeted gift can preserve DSUE before an individual remarries and survives a second spouse, so, under Example 3, can a targeted gift absorb DSUE for purposes of determining whether a decedent preserved any bonus BEA for use at death. Only after DSUE is exhausted must an individual avoid making a targeted gift in order to successfully lock in bonus BEA.

[13] Some members of the Executive Committee found the term "cash gift" imprecise and possibly even inaccurate. It is not the type of property transferred that prevents a transfer from being treated as a targeted gift, but rather the nature of the interests retained. For example, a cash gift made to a grantor retained income trust (a "GRIT") is a targeted gift, whereas an outright gift of property (such as vacant land or securities) generally is not a targeted gift. To avoid confusion, the examples in the final regulations could replace the term "cash gift" with "outright gift of cash."

[14] The relatively close sequence of transfers denoted by the phrase "a few days later" suggests that the Service will respect the formal sequence of a gift that uses up DSUE, followed by a gift that uses up BEA, even if the sequence is a deliberate attempt to use DSUE in order to clear a path for using the enhanced BEA. If that is indeed the intent, we recommend that Treasury and the Service publicly confirm that the sequence of gifts, even if made in close succession, will be respected for purposes of determining the applicable exclusion amount available at death.

[15] *See* Prop. Reg. § 20.2010-1(c)(i)(C).

Given how the portability anti-clawback rule operates, it is understandable that the Treasury and the Service would propose to have the anti-clawback rule of Treas. Reg. § 20.2010-1(c) operate in the same fashion. That is, for the sake of consistency, Example 3, like the portability anti-clawback rule, concludes that a targeted gift can use up DSUE for purposes of determining how much bonus BEA, if any, is available at the donor's death. That said, the result in Example 3 is not compelled by the portability regulations. Conceivably, the final regulations could provide that a targeted gift fails to use up DSUE for purposes of determining how much bonus BEA is available at death, even if a targeted gift, under the portability anti-clawback rule, can preserve DSUE for use by the estate of a decedent who remarried and survived a second spouse.[16] Perhaps it would difficult to rationalize why the consequences of targeted gifts should be different in each context, but a difference in results would be logically possible.

Moreover, apart from conceptual consistency with the portability regulations, it is difficult to see why the Proposed Regulations adopt a favorable rule in the case of the use of DSUE. As explained in the preamble to the Proposed Regulations, Treasury and the Service have concluded, as a matter of policy, that targeted gifts are not legitimate techniques for preserving the applicable exclusion amount before it expires. Yet without explanation in the preamble, the Proposed Regulations propose a rule that favors the use of targeted gifts solely for purposes of determining how DSUE is used. Rather than carve out an exception for DSUE, Treasury and the Service may wish instead to adopt a consistent policy on targeted gifts. Specifically, Treasury and the Service may wish to consider proposing modifications to the portability anti-clawback rule that would prevent the use of targeted gifts to lock in DSUE before remarriage and survival of a second spouse.[17] With those changes made, the final anti-abuse rule regulations could likewise provide that a targeted gift that uses up DSUE for gift tax purposes is nevertheless disregarded for estate tax purposes when determining how much bonus BEA is available to a donor's estate. To illustrate the effect of that rule, Example 3's conclusion could then reversed so as to provide that an enforceable promise gift does not successfully use up DSUE for estate tax computation purposes.

Standard BEA. As discussed, the Proposed Regulations provide an example clearly demonstrating the effect of a targeted gift on the use of DSUE. By contrast, the Proposed Regulations do not explicitly address a targeted gift's effect on the use of the standard BEA.

[16] Suppose that Treasury and the Service do decide that the final regulations will diverge from the portability anti-clawback rule in the use of DSUE. The effects of a targeted gift could then be illustrated with the following example: Donor A, who has inherited $2 million of DSUE, makes a $2 million enforceable promise gift and $9 million outright cash gift a few days later, both in a year when the BEA is $11.4 million. A remarries and survives a second spouse, from whom A inherits no DSUE. A dies in a year when the BEA is $6.8 million. Despite having surviving a second spouse, A's estate can use $2 million of DSUE, thanks to the enforceable promise gift. However, for purposes of determining how much bonus BEA can be used, the enforceable promise gift is disregarded. A's estate has only $7 million of BEA (not $9 million, as in Example 3 of the Proposed Regulations).

[17] See Section 2010(c)(6) for Treasury's authority to prescribe regulations that are appropriate to carry out the portability regime.

Nevertheless, we think that the results under the Proposed Regulations are clear. Consider the following example:

> A decedent dies when the BEA is $6.8 million. At a time when the BEA was $11.4 million, the decedent made an enforceable promise gift of $6.8 million. A few days later, the decedent made an outright gift of cash to the individual's child of $4.6 million.

In this example, for gift tax purposes, a targeted gift (i.e., a gift in the form of a promise that is enforceable under state law) uses up the standard BEA of $6.8 million, while a non-targeted gift (i.e., the outright cash gift) uses up the bonus BEA. For purposes of determining how much BEA is available at death, however, the Proposed Regulations disregard the targeted gift, so that the non-targeted gift of cash is deemed to be applied against only the standard BEA and fails to preserve any bonus BEA. The general anti-clawback rule, after all, provides that a decedent's taxable gifts must exceed the standard BEA in order to preserve bonus BEA for use at death.[18] That is, the standard BEA must be exhausted before any bonus BEA can be preserved. No similar ordering rule appears in the Proposed Regulations. Thus, any targeted gift, including the $6.8 million enforceable promise gift in the foregoing example, is presumably disregarded in determining how much BEA a decedent used, even if, for gift tax purposes, the targeted gift was in fact applied against the standard BEA.

Example 2 of the Proposed Regulations confirms our interpretation that targeted gifts cannot use up standard BEA. In Example 2, a decedent simultaneously made both a $2 million enforceable promise gift and a $9 million cash gift (presumably, once again, without retaining an interest in the cash transferred[19]), for total taxable gifts of $11 million. The example concludes that the decedent's estate computes estate tax based on a BEA of $9 million; that is, despite that the decedent, for gift tax purposes, made a total of $11 million of taxable gifts, the decedent's estate enjoys only the standard BEA of $6.8 million plus $2.2 million of bonus BEA, for a total of $9 million. If instead it were possible for a targeted gift, such as an enforceable promise gift, to use up standard BEA, then the example would instead conclude (or at least allow, depending on the sequence of the gifts[20]) that the $2 million enforceable promise gift uses up $2 million of standard BEA, while the $9 million cash gift uses up the remaining $4.8 million of standard BEA, plus $4.2 million of bonus BEA. The total BEA available to the decedent's estate in that case would be $11 million, comprising $6.8 million of standard BEA and $4.2 million of BEA.

Although we do not disagree with the approach of the Proposed Regulations, reasonable minds may differ on whether targeted gifts should be allowed to absorb standard BEA. The Proposed Regulations themselves, by allowing the use of targeted gifts to absorb DSUE, provide some support for the view that targeted gifts should also be allowed to use up

[18] Treas. Reg. § 20.2010-1(c).

[19] As noted *supra* in footnote 13, some may find the term "cash gift" misleading. To avoid confusion, the term could be replaced in the final regulations with "outright cash gift."

[20] That that the two gifts in Example 2 are made simultaneously is somewhat confusing, and could be read to suggest that (as in Example 3, dealing with DSUE) the order of the gifts has an effect on the analysis. We believe this is not what was intended by the drafters.

standard BEA. The DSUE and the standard BEA, after all, function similarly for purposes of determining how much applicable exclusion amount is available at death, in that both must be exhausted before any bonus BEA under the anti-clawback rule can be preserved. Treasury and the Service having decided that targeted gifts are acceptable in the DSUE context, consistency arguably favors a policy of also allowing targeted gifts up until the point that bonus BEA begins to be used.

Some may further argue that a targeted gift, standing alone, is not an abuse that should prevent the use of either DSUE or standard BEA. After all, if a decedent made an enforceable promise gift of $6.8 million but no other taxable gifts, and dies in a year when the BEA is $6.8 million, the anti-clawback rule has no effect. The BEA in that case would always be $6.8 million, with or without the anti-clawback rule, because the decedent's taxable gifts do not exceed the BEA available at death. Arguably, therefore, the potential for abuse does not begin until after the standard BEA (together with any DSUE) is exhausted. Only at that point should targeted gifts fail to lock in bonus BEA.[21]

That said, the approach of the Proposed Regulations also has merit. As the preamble explains, targeted gifts are "essentially testamentary," in that they permit the donor to postpone until death the actual surrender of beneficial enjoyment. Given their essentially testamentary character, such gifts arguably should no more be allowed to facilitate the use of bonus BEA, by first absorbing DSUE and standard BEA, than to use bonus BEA directly.

Furthermore, if targeted gifts are permitted to use up either DSUE or standard BEA, then the amount of tax imposed at death will depend on the sequence of gifts, even if (as Example 3 provides) the gifts are made no more than "a few days" apart. Similarly situated taxpayers would then be treated differently merely because of the order in which they make targeted and non-targeted gifts. If a decedent does make both targeted and non-targeted gifts, but the targeted gifts, as the Proposed Regulations provide, are always disregarded for purposes of determining whether any standard BEA was used, then any "clawback" tax at death should, conceptually, be viewed as imposed on the targeted gifts, regardless of sequence.[22] Thus, to ensure that targeted gifts are ultimately taxed without the benefit of enhanced exclusion, it is necessary for the final regulations to prohibit the use targeted gifts in order to absorb standard BEA.

We do not take a position on whether targeted gifts should be permissible techniques for using up either DSUE or standard BEA. That said, we do recommend that the final regulations address the disparity in treatment. Example 3 clearly permits targeted gifts to

[21] We also note, in case it is considered relevant, that denying the use of targeted gifts as a technique for absorbing both DSUE and BEA would require taxpayers to pay gift tax in order to ensure that the bonus BEA is preserved. In other words, a tax would need to be paid as the price of preserving an exclusion at death.

[22] For example, suppose that a decedent made both a $6 million targeted gift and a $6 million non-targeted gift, in each case when the BEA is $12 million, and dies in a year when the BEA is $6 million. If a clawback tax is due because the $6 million targeted gift is disregarded, then the tax is effectively imposed on the targeted gift, regardless of the order in which the two gifts are made.

use up DSUE, yet the Proposed Regulations appear to take a different approach to the use of standard BEA. We do not see a strong basis for adopting a different policy in the latter case (standard BEA) than in the former (DSUE). If Treasury and the Service agree that the policies in both cases are aligned, then we think consideration should be given to broadening Example 3 to cover the standard BEA. If, on the contrary, there are policy reasons to treat DSUE and standard BEA differently, such that inconsistent results are preferable, then we think those results should be explicitly stated in an example and the rationale for the difference in result spelled out. Finally, if it is determined that the conclusion animating the result in Example 3 is incorrect, then we suggest that the final regulations retain the Example but reverse its conclusion, so that a targeted gift may not use up DSUE after all. In that case, as discussed above, Treasury and the Service may at the same time wish to propose amendments to the portability regulations that similarly provide that targeted gifts cannot be used to preserve DSUE before it is lost following remarriage and survival of a second spouse.

In all events, regardless of which approach the Treasury and the Service decide to adopt, we recommend, to avoid uncertainty, that the final regulations include an example expressly determining whether a targeted gift does or does not use up standard BEA. Such an example would either extend or stand in contrast to Example 3, which illustrates the effect a targeted gift on DSUE. If the final regulations maintain the apparent (if perhaps conceptually inconsistent) approach of the Proposed Regulations, then the two examples together would establish that, while a targeted gift may use up DSUE, it cannot use up any standard BEA. Alternatively, if the final regulations decide to treat DSUE and standard BEA in the same fashion, then the two examples would show either that (a) targeted gifts use up neither DSUE nor standard BEA or (b) targeted gifts are permitted techniques for using up both.

III. DEFINING THE CATEGORIES OF TARGETED GIFTS

We have two comments on how the proposed regulations define the categories of targeted gifts. The first is purely a drafting suggestion. Prop. Reg. § 20.2010-1(c)(3)(i) begins by identifying two general categories of targeted gifts, namely, “transfers includible in the gross estate” and transfers “treated as includible in the gross estate for purposes of section 2001(b).” It then goes on to enumerate four types of targeted gifts, designated by clauses (A) through (D). Given the four enumerated types of targeted gifts, we think the two general categories set forth at the beginning of Prop. Reg. § 20.2010-1(c)(3)(i) are both unnecessary and confusing. They are unnecessary because it appears that clauses (A) and (B) of Prop. Reg. § 20.2010-1(c)(3)(i) exhaustively account, respectively, for “transfers includible in the gross estate” and transfers “treated as includible in the gross estate for purposes of section 2001(b).”[23] They are confusing because clauses (C) and (D) describe transfers that are neither includible nor treated as includible in the gross estate. Rather than potentially mislead the reader into thinking that clauses (C) and (D) are instances of the two general categories of targeted gifts, the final regulations should instead acknowledge that they treat certain gifts as targeted gifts, regardless of whether they are included in the gross estate or treated as includible. Given the broad regulatory authority granted

[23] That said, it is unclear why clause (A) omits mention of Section 2039, which is one of the “string” Sections that can cause transfers during lifetime to be included in a decedent’s gross estate at death. Treasury and the Service may wish to include a reference to Section 2039 in the final regulations.

by Section 2001(g)(2), Treasury need not view gross estate inclusion as a necessary predicate for treating a transfer of property as a targeted gift.

Second, the Proposed Regulations do not explicitly address the impact of gifts that have the same economic effect as enforceable promise gifts. For example, suppose that a decedent made an outright cash gift of $9 million to the decedent's child, and that the child later lent the $9 million back to the decedent. Suppose, further, that the note remains unpaid on the decedent's death. This arrangement is economically similar to the enforceable promise gift described in Example 1 of the Proposed Regulations. Yet the arrangement, if it can survive scrutiny under substance-over-form principles, including the step transaction doctrine,[24] would apparently allow the decedent to lock in bonus BEA, even though an equivalent enforceable promise gift would not. Rather than rely on the uncertain impact of substance-over-form principles, Treasury and the Service may wish to define a gift followed by a loan back to the donor as *per se* a targeted gift, if the loan occurs within certain period (such as 18 months of three years) following the gift.

IV. TREATMENT OF QUALIFIED PAYMENT RIGHTS

The Proposed Regulations provide that a transfer described in Treas. Reg. § 25.2701-5(a)(4) does not preserve BEA for purposes of calculating a decedent's estate tax.[25] Treas. Reg. § 25.2701-5(a)(4), in turn, is found in the rules designed to mitigate the double taxation which may result upon the subsequent transfer of an interest that had previously been valued under Section 2701.[26] For purposes of those mitigation rules, Treas. Reg. § 25.2701-5(a)(4), in defining the technical term "section 2701 interest," refers to an "applicable retained interest that was valued using the special valuation rules of section 2701 at the time of the initial transfer." Thus, under the Proposed Regulations, if a transfer – described in Treas. Reg. § 25.2701-5(a)(4) as the "initial transfer"[27] – triggered the Section 2701 special valuation rules as a result of the retention of an applicable retained interest, then the Proposed Regulations would prevent that transfer from using up BEA for estate tax computation purposes.

The Proposed Regulations' cross-reference to Treas. Reg. § 25.2701-5(a)(4) leaves it uncertain whether the benefit of the anti-clawback rule would be denied in the case of a

[24] Whether a given arrangement can be recharacterized under substance-over-form principles may be uncertain and depends on all the facts and circumstances. *Cf. Flandreau v. Comm'r,* 994 F. 2d 91 (2d Cir. 1993) (rejecting a deduction under Section 2053 for loans outstanding at death where gifts to family members were followed by loans back to the taxpayer of the same amount); *but cf. Linton v. U.S.*, 630 F.3d 1211 (9th Cir. 2011), *aff'g in part and rev'g in part* 638 F. Supp. 2d 1277 (W.D. Wash. 2009) (rejecting the application of step transaction doctrine where documents executing a series of transfers were all executed on the same day).

[25] *See* Prop. Reg. § 20.2010-1(c)(3)(i)(c).

[26] *See* Treas. Reg. § 25.2701-5(a)(4).

[27] Presumably, it is the *initial* transfer triggering Section 2701 – not the later transfer of an applicable interest, the treatment of which is addressed by the Treas. Reg. § 25.2701-5 mitigation rules – that the Proposed Regulations intend to treat as a transfer that fails to use up BEA. It would be helpful if the final regulations clarified that the "transfers" described in the Prop. Reg. § 20.2010-1(c)(3)(i)(C) are "initial" transfers referred in Treas. Reg. § 25.2701-5(a)(4).

retained qualified payment right. Generally, the retention of a "qualified payment right" does not cause the value of a gift to be artificially increased under Section 2701.[28] Nevertheless, it does technically trigger the special valuation procedures of Section 2701 (assuming that the transferor and certain "applicable family members" are considered to control the entity that issues the qualified payment right).[29] Moreover, there are limited circumstances where an applicable retained interest that is a qualified payment right will in fact be valued by taking into account adverse Section 2701 valuation rules.[30] Thus, it is unclear whether a "qualified payment right" should be considered, for purpose of the Proposed Regulations, to have been "valued using the special valuation rules of section 2701."

Meanwhile, the intent of the Proposed Regulations is uncertain. The Proposed Regulations allow a donor to retain a right to guaranteed payments of a fixed amount or a mandatory payment right, yet still preserve BEA through a gift a subordinate equity interest in an entity.[31] There does not appear to be a reason to treat qualified payment rights less favorably than guaranteed payment or mandatory payment rights. Further, the Section 2701 mitigation rules do not take into account the value of any qualified payment right in determining the value that may be duplicated by a subsequent transfer of a Section 2701 interest, which suggests that the retention of a qualified payment right should not cause a transfer to fail to preserve bonus BEA.[32] On the other hand, as discussed below, the Proposed Regulations would generally treat a transfer in trust as a targeted gift if the donor retains a fixed annuity or unitrust interest. It is unclear why the retention of an annuity or unitrust interest in a trust would be treated less favorably than the retention of a qualified payment right in an entity. In both cases, the transferred property is effectively encumbered by the donor's retention of the right to a stream of payments.

[28] A "qualified payment right" is (i) the right to receive a dividend payable at least annually under cumulative preferred stock, (ii) the right to receive any other cumulative distribution payable at least annually with respect to an equity interest, to the extent determined at a fixed rate or as a fixed amount, or (iii) any other distribution right for which a qualified payment election has been made pursuant to Treas. Reg. § 25.2701-2(c). IRC § 2701(c)(3); Treas. Reg. § 25.2701-2(b)(6).

[29] A qualified payment right is a form of distribution right within the meaning of Section 2701(c)(1). *See* IRC § 2701(a)(3). Thus, in the case of a transfer of an interest in a controlled entity, the retention of a qualified payment right requires the application of Section 2701's "subtraction" method in order to determine the value of the gift. *See* Treas. Reg. § 25.2701-1(a).

[30] *See* Section 2701(a)(3) and Treas. Reg. §§ 25.2701-2(a)(2)-(4) (providing that Section 2701 does not apply to an applicable retained interest that confers the right to receive a qualified payment, unless there are one or more liquidation, put, call, or conversion rights with respect to such interest).

[31] Neither a right to guaranteed payments of fixed amounts nor a mandatory payment right is an "applicable retained interest" that causes Section 2701 to apply. IRC § 2701(c)(1)(B)(iii); Treas. Reg. § 25.2701-2(b)(4)(i), (iii). Thus, Prop. Reg. § 20.2010-1(c)(i)(C) does not cause a transfer of an equity interest that is subordinate to such a preferred right to be treated as a targeted gift.

[32] *See* Treas. Reg. § 25.2701-5(c).

To eliminate the foregoing uncertainties, we recommend that Treasury and the Service clarify in the final regulations that the retention of a qualified payment right would not cause a transfer to be treated as a targeted gift for estate tax computation purposes.

V. EXCEPTION TO THE DEFINITION OF TARGETED GIFTS

The purpose of the Proposed Regulations, as described in the preamble, is to prevent individuals from locking in bonus BEA with transfers that, while treated as gifts for gift tax purposes, do not actually "depriv[e] the donor of the use and enjoyment of the property." The preamble recognizes, however, that some transfers that might otherwise be treated as targeted gifts are not intended to permit the retention of the use and enjoyment of transferred property. So that the anti-abuse rule is not overbroad, the Proposed Regulations include a bright-line exception to the general definition of targeted gifts. Specifically, the Proposed Regulations provide that even if a transfer is includible in the gross estate, it is not considered a targeted gift if the taxable portion of the gift is 5% or less of the value of the transferred property.

Although we support a bright-line exception to the definition of targeted gifts, we recommend that Treasury and the Service reconsider the 5% test and craft a different exception that better distinguishes between transfers that do not actually deprive the donor of use and enjoyment of property – which should be treated as targeted gifts – and those where the donor actually surrenders beneficial use and enjoyment – which should not be considered targeted gifts. As discussed below, the 5% test does not provide an accurate approximation of whether a particular transfer was intended to take inappropriate advantage of the bonus BEA. Indeed, the 5% test seems to cut against the policy objectives described in the preamble: Whereas the rationale for denying the favorable anti-clawback rule to targeted gifts is to prevent the use of bonus BEA in cases where the donor effectively retains the beneficial enjoyment of the transferred property, the 5% test favors the retention of virtually all of the beneficial enjoyment, while rarely providing relief in cases where beneficial enjoyment is surrendered.

For example, suppose that a parent transfers $10 million to a trust for the exclusive benefit of a child, but retains the right to determine the timing and amount of distributions to the beneficiary. The initial transfer is treated for gift tax purposes as a completed $10 million gift.[33] At the donor's death, however, the donor's retained power causes gross estate inclusion under Sections 2036(a)(2) and Section 2038(a).[34] In this situation, the donor retains none of the beneficial enjoyment of the trust property.[35] The rationale for denying the favorable

[33] Treas. Reg. § 25.2511-2(d).

[34] *Estate of Alexander*, 81 T.C. 757 (1983) (holding that Section 2036(a)(2) causes gross estate inclusion where the decedent retains a mere power over the timing of the enjoyment of income); Treas. Reg. § 20.2038-1(a)("Section 2038 is applicable to any power affecting the time or manner of enjoyment of property or its income, even though the identity of the beneficiary is not affected.").

[35] Transferred property can also be included in the gross estate, despite that the donor retains no beneficial enjoyment, in the case of a retained right to vote stock in a controlled corporation under Section 2036(b) or in the case of retained "incidents of ownership" over a life insurance policy under Section 2042(2).

anti-clawback rule, therefore, does not seem to apply. Nevertheless, the 5% exception does not help the taxpayer, as the entire transfer (far more than 5%) is treated a taxable gift.

We recognize that the preamble sometimes describes the rationale for the Proposed Regulations more broadly. For example, at one point, the preamble mentions "circumstances where the donor continues to have the title, possession, use, benefit, control, or enjoyment of the transferred property during life." The references to "title" and "control" could suggest that Treasury and the Service intend to deny the benefit of the anti-clawback rule where the decedent retains any power over transferred property that causes gross estate inclusion, even if the decedent did not retain any beneficial use or enjoyment for himself or herself. If that is the intent, then even a parent who retains no more than a power to control the timing of distributions to a child should not be able to lock in bonus BEA. If instead the intent is only to target gifts where the donor retains beneficial access, then the mere retention or possession of a taxable power should not by itself prevent a taxpayer from preserving bonus BEA. Rather, only the donor's effective retention of the right to the income, use, or enjoyment of the transferred property would be targeted.

If Treasury's and the Service's goal is only to prevent a donor from preserving bonus BEA while at the same time retaining beneficial access, then, in light of that goal, we note that, in some instances, the donor may retain a fixed interest in transferred property while fully surrendering the remainder. Consider, for example, the following three donors:

> Donor A transfers $10 million outright to A's child. Donor A simultaneously transfers $5 million to a grantor retained annuity trust (GRAT) in which A retains a qualified annuity interest having a present value at the time of the gift of $4,750,000. The remainder of the GRAT is directed to be paid over to A's child.
>
> Donor B makes a $15 million gift to a GRAT. Like A, individual B retains a qualified annuity interest having a present value at the time of the gift of $4,750,000. The remainder of the GRAT is directed to be paid over to B's child.
>
> Donor C transfers $15 million to a limited liability company (LLC) having two classes of interests. Class 1 confers a right to guaranteed payments in fixed amounts, and has a fair market value for gift tax purposes of $4,750,000. Class 2 entitles the holder to the balance of the LLC's assets, after all guaranteed payments are made to the Class 1 interest holders. C makes a gift of the subordinate class 2 interests to C's child and retains the preferred class 1 guaranteed payment right.

In all three of the foregoing examples, the donor transfers a total of $15 million and retains a right to a fixed stream of payments having a present value of $4,750,000. Also in all three examples, the donor is treated, for gift tax purposes, as making taxable gifts of $10,250,000.[36]

[36] For simplicity, we ignore the effect of the gift tax annual exclusion under Section 2503(b). For the application of the "subtraction method" to the valuation of a guaranteed payment right, see *Smaldino v. Comm'r*, T.C. Memo. 2021-127. The subtraction method operates similarly to

Finally, in none of the three examples is the transfer subject to the special valuation rules of chapter 14 of the Code,[37] nor does the donor retain an interest in the $10,250,000 remainder.

Despite the similar economics and identical gift tax treatment of the donors in the foregoing examples, the results under the Proposed Regulations are very different. Donor A successfully preserves $10,250,000 of BEA, as A's $10 million outright gift is not a targeted gift, while the gift of the GRAT remainder qualifies for the 5% exception. Likewise, donor C successfully preserves $10,250,000 of BEA, as C's gift of subordinate class 2 interests is not a targeted gift.[38] Yet donor B, despite having surrendered a remainder interest valued for gift tax purposes at $10,250,000, fails to preserve bonus BEA if B dies holding the retained annuity interest.[39]

The apparently arbitrary disparity in results arises because the 5% exception fails to exclude donor B's gift from the definition of targeted gifts. The 5% exception only applies where the donor has retained 95% of more of the beneficial interests. In other words, to avoid a targeted gift while retaining an interest, a donor (if the donor does not outlive the retained interest) needs to retain virtually all of the beneficial enjoyment of the transferred property. Yet the retention of beneficial enjoyment is the very abuse that the Proposed Regulations target. The retention of virtually all beneficial interests in transferred property is also disfavored in other contexts.[40] If anything, it seems that where the requirements of the 5% rule are satisfied – such as in the case of a GRAT where the remainder has been virtually zeroed out – the benefit of the anti-clawback rule should be expressly denied, even if the donor outlives the retained interest and avoids gross estate inclusion.

the gift tax valuation of a transfer subject to a retained interest. *See* Treas. Reg. § 25.2512-5(d)(2).

[37] The donors' retained interests in the GRATs are qualified annuity interests that comply with the requirement of Section 2702(b)(1). Section 2701 does not apply to the retained guaranteed payment right. IRC § 2701(c)(1)(B)(iii).

[38] As noted, Section 2701 does not apply to the retention of guaranteed payment right of a fixed amount. IRC § 2701(c)(1)(B)(iii). Thus, Prop. Reg. § 20.2010-1(c)(i)(C) does not treat donor C's transfer as a targeted gift.

[39] We note that the Proposed Regulations do not address the treatment of targeted gifts that result in only partial gross estate inclusion. Suppose, for example, that a donor makes a gift in trust and retains the right to only one-half of the income for life. At death, only one-half of the trust will be included the donor's gross estate. Treas. Reg. § 20.2036-1(c)(1)(i). Presumably, only one-half of the taxable gift in that case would be denied the benefit of the anti-clawback rule. Treasury and the Service may wish to provide rules on the effect of partial gross estate inclusion. Alternatively, Treasury and the Service could reserve space for rules on this topic.

[40] Under Section 2701(a)(4), a junior equity interest may not be valued at an amount that is less than 10% of the total value of all equity interests. *See also* T.D. 8395, 1992-1 C.B. 316 ("The Treasury Department and the Service believe that such a result [i.e., allowing a gift to a GRAT to be "zeroed out"] would be inconsistent with the principles of section 2702.").

In any event, so that policy of the Proposed Regulations can be better realized, we recommend that the Treasury and the Service abandon the 5% rule.[41] Treasury and the Service should provide an exception to the definition of targeted gifts in cases where the donor retains no beneficial interest at all [42] or retains no more than a qualified retained interest within the meaning of Section 2702(b). In such cases, the donor's taxable gift is not artificially inflated by the chapter 14 valuation rules. Further, the retained interest, because it is either a fixed annuity or unitrust amount, is not subject to manipulation; that is, a qualified retained interest does not permit the donor any access to the property interests that are given away.[43] Indeed, the Proposed Regulations, by permitting the retention of guaranteed payment rights in entities,[44] already correctly recognize that the retention of a right to payments in fixed amounts is not an abuse that should prevent the favorable anti-clawback rule from applying. Where such a right is retained, the donor has divested himself or herself of all transferred property other than the retained interest.[45] Thus, the anti-clawback rule arguably should still apply.

VI. POTENTIAL DISPARITIES CREATED BY THE 18-MONTH RULE

Pursuant to the Proposed Regulations, certain transfers which would have constituted targeted gifts but for the transfer, relinquishment or elimination of an interest, power, or property effectuated within 18 months of the date of the decedent's death, continue to be categorized as targeted gifts.[46] Despite the Proposed Regulation's adoption of this 18-month

[41] Alternatively, the final regulations could retain the 5% rule as a *de minimis* rule that is supplemented with other exceptions to the definition of targeted gifts.

[42] To allow for remote contingencies, such as default state law reversions in the unlikely event that all beneficiaries are deceased, the final regulations could approved the retention of *de minimis* contingent interests whose actuarial value at the time of transfer is less than 5% of the property transferred.

[43] Congress has long recognized that retained annuity and unitrust interest are not susceptible to manipulation or abuse. *See* IRC §§ 664(d), 2702(b).

[44] The Proposed Regulations, once clarified as discussed above, would also permit the retention of qualified payment rights, as well as mandatory payment rights described in Treas. Reg. § 25.2701-2(b)(4)(i).

[45] Under this approach, personal residence trusts authorized under Section 2702(a)(3)(A)(ii) are perhaps a borderline case. On the one hand, a personal residence trust or "house GRIT" is a form of grantor-retained income trust that permits the donor to retain beneficial enjoyment of trust property. On the other, they are expressly approved by Congress and Treasury Regulations as a technique for making taxable gifts. *See* Treas. Reg. § 25.2702-5. Treasury and the Service may wish to consider further whether gifts of remainders in personal residence trusts should be permitted to preserve bonus BEA.

[46] *See* Prop. Reg. § 20.2010-1(c)(3)(i)(D). The Proposed Regulations further provide that an otherwise targeted gift will convert to nontargeted status if termination is effectuated "by the termination of the durational period described by the original instrument of transfer by either the mere passage of time or the death of any person." Prop. Reg. § 20.2010-1(c)(3)(ii)(A). For example, if a decedent created a GRIT for a period of years, and survives the fixed period, the gift to the GRIT is not a targeted gift, even if the decedent dies shortly after the fixed period ends. We recommend, for clarity, that Prop. Reg. § 20.2010-1(c)(3)(ii)(A) be revised or supplemented to provide that, in similar fashion, an enforceable promise gift converts to a non-

rule, a statutory three-year rule would in certain cases still cause a loss of bonus BEA. Specifically, gifts includible in the gross estate pursuant to Section 2035 constitute targeted gifts.[47] Section 2035, in turn, provides that if an individual transferred an interest in property or relinquished a power within three years prior to death and, but for the transfer or relinquishment the property would have been includible in the individual's gross estate under Section 2035, 2037, 2038, or 2042, the value of the transferred property is includible in the individual's gross estate.[48] Because Section 2035 creates a three-year tail period, while the Proposed Regulations adopt an 18-month tail period, the Proposed Regulations would result in the disparate treatment of otherwise similarly situated individuals.

For example, consider an individual who makes a $9 million enforceable promise gift at a time when the basic exclusion amount is $11.4 million. Assume the individual subsequently satisfies the promised payment. Assume further that, two years after satisfying the promised payment, when the basic exclusion amount is $6.8 million, the individual dies. Under the Proposed Regulations, because the transfer in satisfaction of the promised payment occurs more than 18 months prior to death, the credit to be applied for purposes of calculating the individual's estate tax will be based on a $9 million basic exclusion amount.

A different outcome would result if the transfer were includible in the individual's gross estate pursuant to Section 2035. For example, consider an individual who transfers $9 million to a grantor retained income trust at a time when the BEA is $11.4 million. Assume that the individual subsequently relinquishes the income interest in the trust. Assume further that the individual dies two years after the relinquishment, when the basic exclusion amount is $6.8 million. Because the individual relinquished the income interest within three years of death, the entire value of the trust would be includible in the individual's gross estate pursuant to Section 2035.[49] Therefore, under the Proposed Regulations, the credit to be applied for purposes of computing the individual's estate tax will be based on the $6.8 million basic exclusion amount.[50]

Given that Section 2035 and the 18-month rule set forth in the Proposed Regulations both address the potential avoidance of the anti-abuse provisions of the Proposed Regulations through transfers shortly prior to death, we recommend that Treasury and the Service eliminate the disparities in outcomes in the case of changes that occur in the period that

targeted gift if the promise is repaid during lifetime upon the promise becoming due at a fixed maturity date. In addition, to avoid confusion, we recommend that the term "death of any person" in Prop. Reg. § 20.2010-1(c)(3)(ii)(A) be replaced with "death of any person (other than the donor)," so that the regulation is not erroneously interpreted to mean that a retained interest that terminates at the donor's death is not a targeted gift.

[47] *See* Prop. Reg. § 20.2010-1(c)(3)(i)(A).

[48] *See* IRC § 2035(a).

[49] *See* IRC § 2035(a).

[50]*See* Prop. Reg. § 20.2010-1(c)(3)(i)(A). The result under the Proposed Regulations will be different if, instead of relinquishing the retained income interest, the individual sells the interest to a third party for full and adequate consideration two years prior to death. *See* IRC § 2035(d); *see generally U.S. v. Allen*, 8 AFTR 2d 6055 (10th Cir. 1961). In this circumstance, the credit to be applied for purposes of computing the individual's estate tax will be calculated taking into account the increased basic exclusion amount. See Appendix for a chart of the disparities.

is more than 18 months before death but not more than three years before death. One way to eliminate those disparities is to exclude transfers that are includible in the gross estate under Section 2035(a) from the definition of targeted gifts found in paragraph (c)(3)(i) of the Proposed Regulations. With the three-year rule of Section 2035(a) disregarded, only actions taken within 18 months of death would fail to convert a targeted gift to a non-targeted gift that successfully locks in bonus BEA. Alternatively, if Treasury and the Service conclude that a uniform 18-month rule is too generous, the final regulations could replace the 18-month period in Prop. Reg. § 20.2010-1(c)(3)(i)(D) with a period of three years. Given the three-year periods found for various purposes in Section 2035 and Section 2038(a), a three-year period arguably has more precedent than 18 months.[51] The final regulations, under that approach, would impose a uniform three-year period before death when attempts to convert a targeted gift into a non-targeted gift would fail, regardless of whether Section 2035(a) applies.

[51] *But cf.* Treas. Reg. § 25.7520-3(b)(3)(presuming that donor is not terminally ill if he or she survives eighteen months or longer after the date of a gift).

APPENDIX

Disparities in Termination of an Interest before Death

The following chart illustrates the disparities described in section VI of the Report:

	Transfer, relinquishment or sale within 18 months of death	**Transfer, relinquishment or sale more than 18 months but less than 3 years prior to death**	**Transfer, relinquishment or sale more than 3 years prior to death**
Transfer in satisfaction of promise to make a payment	Credit will not take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount
Transfer of a retained Section 2701 interest	Credit will not take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount
Relinquishment of income interest in GRIT	Credit will not take into account expanded basic exclusion amount	Credit will not take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount
Elimination of income interest in a GRIT (other than by relinquishment for less than full and adequate consideration)	Credit will not take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount	Credit will take into account expanded basic exclusion amount