South Carolina Bar
Continuing Legal Education Division

2026 SC BAR CONVENTION

Probate, Estate Planning, & Trust Section

"State and Federal Tax Planning, Legislative Update and Planning Opportunities"

Friday, January 23

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South Carolina Bar

Continuing Legal Education Division

Post-Mortem Planning

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BUT I'M NOT DEAD YET!

Exploring Ante-Mortem Probate

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I. Fighting the Undead

1. **Issue**

a. Most attorneys have had one or two (or more) clients who knew that their estate was going to be contested. Whether it be long-term infighting amongst their children or a broken relationship with a certain child who is particularly litigious, some clients know a Will contest will rise up soon after their passing. While in terrorem clauses (AKA – no contest clauses) provide some assistance, they are far from perfect and have limited applicability. Sadly, South Carolina estate planners have very little else to offer these clients to address this issue.

b. However, several states have added provisions to their statutes governing probate and trust administration to directly deal with such issues by providing a means to hold an Ante-Mortem Probate (AKA - Pre-Mortem Probate) proceeding.

c. Ante-mortem probate is the process of proving a testator's Will or Codicil to be valid while the testator is still alive. Several states have provided the same procedure for Revocable Trusts, some of which can be held as a single proceeding.

d. This outline is intended to be both a general examination of the ante-mortem probate process, with particular attention paid to the process adopted by North Carolina as well as an exploration of what a South Carolina ante-mortem probate statute might look like.

II. Survey of Existing Ante-Mortem Probate Legislation

1. Overview

a. Ante-mortem probate is a relatively new concept.[1] To date, only 7 states have adopted ante-mortem probate statutes:

i. North Dakota (1977)
ii. Ohio (1978)
iii. Arkansas (1979)
iv. Alaska (2010)
v. New Hampshire (2014)
vi. Delaware (2015)
vii. North Carolina (2015)

[1] One commentator noted that the story of Jacob and Esau essentially beings with an act of undue influence leading to the validation of what amounted to a testamentary act of passing Issac's estate to his younger son, rather than the older. *See Genesis* 27.

b. Nevada and South Dakota permit ante-mortem probate, but they do so by listing Wills and Revocable Trusts in their generic declaratory judgment statutes.

c. Multiple courts have struggled with the idea of ante-mortem probate over the years, mostly with the idea that "the living can have no heirs,"[2] and that there are no interested parties to a testator's Will until the testator is dead.

d. The drafters of the Uniform Probate Code attempted to create a uniform ante-mortem probate act, but they failed to agree on the type of statute that should be used. Unfortunately, that project was abandoned and we have no indication that any effort to create a uniform statute is underway.[3]

e. There is not a great degree of variety amongst the ante-mortem probate statutes adopted thus far.[4] They generally take the form of a Will contest held during the testator's life. There is some differentiation between certain requirements that will be discussed as appropriate in the following analysis.

III. Review of North Carolina Statutes

a. **Living Probate –** North Carolina's ante-mortem probate statute is relatively new. In addition, as their general provisions are quite similar to South Carolina's and several attorneys practice on both sides of our shared boarder, examination of their statute is warranted.[5]

b. **Standing, Procedure and Venue**

i. § 28A-2B-2 provides that venue is proper in the county in which the petition resides.[6] Thus, the petitioner must seek an ante-mortem probate in the county in which their post-mortem probate would be held.

ii. § 28A-2B-1(a) provides that a petitioner must be a resident of North Carolina and have executed a Will[7] in order to seek a judicial declaration that the Will in question is valid.

iii. § 28A-2B-1(b) provides that the petition must be filed with the clerk of superior court and the matter will proceed as a post-mortem contested probate proceeding governed by Article 2 of Chapter 28A.[8]

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[2] *Lloyd v. Wayne Circuit Judge*, 23 N.W. 28, 30 (Mich. 1885).
[3] Jacob A. Bradley, *Antemortem Probate Is a Bad Idea: Why Antemortem Probate Will Not work and Should Not Work*, 85 Miss. L. J. 1431 (2017)
[4] *Id.* provides a list of other possible methods for antemortem probate. None of these methods have been adopted, and are not likely to be adopted in South Carolina, and thus don't warrant examination.
[5] All of the following sections refer to Wills and Codicils, but I have only referenced Wills for simplicity.
[6] See N.C. GEN. STAT. § 28A-2B-2
[7] *Id.* § 28A-2B-1(a)
[8] *Id.* § 28A-2B-1(b)

1. North Carolina also provides for a proceeding to determine the validity of a Revocable Trust. § 36C-4C-2 provides that a petition filed to determine the validity of a Revocable Trust may also join as an additional claim a request validation of the petitioner's Will.

2. In such a case, a joined action will be heard in the Superior Court Division of the General Court of Justice.

iv. At the hearing on the matter, the petitioner must produce the original Will together with any other evidence necessary to establish that it would be admitted to probate if the petitioner were deceased.

v. If no interested party contests the validity of the Will and if the clerk of superior court determines that the document would be admitted to probate if the petitioner were deceased, the clerk of superior court can enter an order adjudging the document to be valid. It should be noted that this places a great deal of importance on the identity of the "interested parties." This will be discussed in more detail in the section dealing with notice below.

vi. If an interested party contests the validity of the Will, that person must file a written challenge before the hearing or make an objection to the validity of the Will at the hearing. In either event, the clerk must then transfer the cause to the superior court. At that point, the matter will be heard as if it were a caveat proceeding.

c. **Requirements of the Petition**

i. § 28A-2B-3 provides the following requirements for a petition for an ante-mortem probate:[9]

1. A statement that the petitioner is a resident of North Carolina and specifying the county of the petitioner's residence.

2. Allegations that the will was prepared and executed in accordance with North Carolina law and a statement that the will was executed with testamentary intent.

3. A statement that the petitioner had testamentary capacity at the time the will was executed.

4. A statement that the petitioner was free from undue influence and duress and executed the will in the exercise of the petitioner's free will.

[9] *Id.* § 28A-2B-3

5. A statement identifying the petitioner, *and all persons believed by the petitioner to have an interest in the proceeding, including, for any interested parties who are minors, information regarding the minor's appropriate representative*. (Emphasis added)

ii. The petitioner must also file a copy of the Will with the petition and provide the original document at the hearing under § 28A-2B-3(b).[10]

d. **Result**

i. If an order is entered declaring the Will to be valid, the court will affix a certificate of validity to the Will.[11] It is not clear to me if this obviates the need to produce the original Will after the petitioner's death if the original was lost following this proceeding.[12]

ii. If the court enters a judgment declaring a Will to be valid, such judgment is binding upon all parties to the proceeding, including any persons represented. As only parties to this proceeding are bound by its holding, other persons will still be able to bring the normal caveat proceedings without limitation.

iii. No party bound by the judgment shall have any further right to, and shall be barred from filing, a caveat to the validated Will once it is entered into probate following the petitioner's death.

iv. The petitioner can also file a motion requesting the court order that the validated Will cannot be revoked and that no subsequent Will shall be valid unless the revocation or the subsequent Will is declared valid in a similar proceeding. If the court enters such an order, any subsequent revocation of the validated Will will be void unless and until it is later validated.

v. If a Will judicially declared valid is later revoked or modified by a subsequent Will, an interested person is not barred from contesting the validity of that subsequent document, unless it was also declared valid in a similar proceeding to which that interested person was also a party. Moreover, nothing bars an interested person from contesting the legitimacy of a revocation of a validated Will that is revoked by a method other than the execution of a subsequent Will, unless that revocation is also declared

[10] *Id.* § 28A-2B-3(b)
[11] *Id.* § 28A-2B-3(b)
[12] *Id.* § 28A-2B-4

valid in a similar proceeding in which that interested person was a party.[13] However, there is an exception to these limitations for fraud.

vi. Lastly, any party to the proceeding may request that the contents of the file be sealed and kept confidential from public inspection. In such a case, the contents of the file shall not be released except by order of the clerk to any person other than:

1. The petitioner;
2. The petitioner's attorney; and
3. Any court of competent jurisdiction hearing or reviewing the matter.[14]

vii. In addition, the court may order confidential records be made available to any other person for good cause.

viii. Any sealed files will be unsealed after the petitioner's death upon the request of any interested person for the purpose of probate or other estate proceedings.

e. **Notice**

i. One of the biggest points on contention in the topic of ante-mortem probate centers around notice. As the notice requirements in a post-mortem probate context are well settled in each state, the fact that the notification requirements may be different in the ante-mortem probate context causes some concern that parties will not be afforded the opportunity to contest an ante-mortem probate for reasons of never having been notified of the chance to do so. However, as only parties receiving proper notice are bound by the verdict, there is not irreparable harm.

ii. As North Carolina ante-mortem proceedings are handled just as a post-mortem contested probate proceedings, the technical notice requirements are governed by Article 2 of Chapter 28A. However, to whom notice is required is left somewhat open-ended.

iii. § 28A-2B-1 provides that "an interested party" may file a written challenge before a hearing to validate a Will, or may make an objection at the hearing to validate a Will.[15] § 28A-2B-3 provides that the petitioner must list in his petition "all persons believed by the petitioner to

[13] *Id.* § 28A-2B-4(c)
[14] *Id.* § 28A-2B-5
[15] *Id.* § 28A-2B-1.

have an interest in the proceeding, including, for any interested parties who are minors, information regarding the minor's appropriate representative."[16]

iv. This section essentially allows the petitioner to define to whom notice is required. Put another way, it does not appear that the petitioner is required to give notice to any particular party. However, as only parties to the action are bound by the validation of a Will, the petitioner who narrowly defines his "interested parties" does so at his own peril.

v. In addition, it does not appear that a petitioner is limited in any way in providing notice to this action. As such, the petitioner is empowered to provide notice to any person he wishes to bind to the result of this action.

IV. Thoughts on a South Carolina Statute

a. **Big Picture –** While many will argue that any ante-mortem probate statute, however well drafted, will be rarely used, that does not mean that it is not a valuable tool. In certain circumstances, it appears that this kind of action can help ensure a client that their Will and/or Revocable Trust will not be overturned for failure to meet the minimum requirements for validity due to creative arguments applied to facts that may be decades old when considered after the testator's death. As such, it is worth considering how South Carolina might best approach creating its own ante-mortem probate statute.

b. **Standing, Procedure and Venue**

i. Perhaps obviously, limiting these actions to South Carolina residents who have executed a Will and/or Revocable Trust governed by South Carolina law is a wise limitation.

ii. Requiring the petitioner to hold an ante-mortem probate in the county in which their post-mortem probate would be held if they died at the time of the action is also a sensible approach.

iii. In addition, there appears little downside to allowing (or even requiring) a petitioner to bring an action to determine the validity of a Will and Revocable Trust in a single action.

a. In cases where the petitioner is seeking to validate a pourover Will, it does not seem unfair to require the action to include

[16] *Id.* § 28A-2B-3.

a determination as to the validity of the Revocable Trust Agreement in order to promote judicial efficiency.

b. As the Will and Revocable Trust Agreement are inseparable companions in most cases, it seems more harm will come from allowing this to be an option and not a requirement.

iv. Allowing both these matters to be brought in the appropriate Probate Court or, if requested by a party, removed to the Circuit Court, allows for flexibility and is reasonable. Allowing consent orders in the case of uncontested matters is also reasonable, as this also favors judicial efficiency.

v. Requiring the original Will to be presented to the Court should also be required. In addition, it would seem acceptable for the statute to specifically permit a Will found to be valid in an ante-mortem probate proceeding to serve as the original Will for the petitioner's eventual post-mortem probate.

c. **Requirements of the Petition -** The requirements laid out in the North Carolina statute are all necessary and reasonable.

d. **Result**

i. In the even the Will at issues if found to be valid, limiting such finding to only the parties to the action is a reasonable limitation that should not be expanded.

ii. Giving the petitioner the option to request the court order that the now validated Will cannot be revoked and that no subsequent Will shall be valid unless the revocation or the subsequent Will is declared valid could be made mandatory, thereby forcing petitioners to heavily consider such actions before proceeding with them. However, this also impedes testamentary freedom to an extent that may not be acceptable.

iii. Lastly, allowing any party, not just the petitioner, to request that the contents of the file be sealed and kept confidential from public inspection seems reasonable. Still, it may be preferable for the sealed copy of the Will be allowed to serve as the original Will upon the petitioner's death.

e. **Notice**

i. There is a strong argument that the notice requirements for an ante-mortem probate should be at least as broad as those for a post-mortem probate, while still permitting the petitioner to notify additional parties.

ii. This argument rests heavily on the idea that it is most efficient, both in terms of cost and in terms of the administrative and judicial burdens created about by these actions, to require certain parties to notified, and thereby later bound, by these actions.

iii. Similarly, allowing petitioners to provide notice to additional parties in an effort to bind them promotes the same efficiencies.

N.C. Gen. State.
Article 2B – Living Probate.

§ 28A-2B-1. Establishment before death that a will or codicil is valid.

(a) Any petitioner who is a resident of North Carolina and who has executed a will or codicil may file a petition seeking a judicial declaration that the will or codicil is valid.

(b) The petition shall be filed with the clerk of superior court and the matter shall proceed as a contested estate proceeding governed by Article 2 of Chapter 28A of the General Statutes. At the hearing before the clerk of superior court, the petitioner shall produce the original will or codicil and any other evidence necessary to establish that the will or codicil would be admitted to probate if the petitioner were deceased. If an interested party contests the validity of the will or codicil, that person shall file a written challenge to the will or codicil before the hearing or make an objection to the validity of the will or codicil at the hearing. Upon the filing of a challenge or the raising of an issue contesting the validity of the will or codicil, the clerk shall transfer the cause to the superior court. The matter shall be heard as if it were a caveat proceeding, and the court shall make a determination as to the validity of the will or codicil and enter judgment accordingly. If no interested party contests the validity of the will or codicil and if the clerk of superior court determines that the will or codicil would be admitted to probate if the petitioner were deceased, the clerk of superior court shall enter an order adjudging the will or codicil to be valid.

(c) Failure to use the procedure authorized by this Article shall not have any evidentiary or procedural effect on any future probate proceedings.

(d) For purposes of this Article only, a "petitioner" is a person who requests a judicial declaration that confirms the validity of that person's will or codicil. (2015-205, s. 2; 2019-178, s. 1(a).)

§ 28A-2B-2. Venue.

The venue for a petition under G.S. 28A-2B-1 is the county of this State in which the petitioner whose will or codicil is the subject of the petition resides. (2015-205, s. 2; 2017-212, s. 8.2.)

§ 28A-2B-3. Contents of petition for will validity.

(a) Petition. – A petition requesting an order declaring that a petitioner's will or codicil is valid shall be verified and shall contain the following information:

(1) A statement that the petitioner is a resident of North Carolina and specifying the county of the petitioner's residence.

(2) Allegations that the will was prepared and executed in accordance with North Carolina law and a statement that the will was executed with testamentary intent.

(3) A statement that the petitioner had testamentary capacity at the time the will was executed.

(4) A statement that the petitioner was free from undue influence and duress and executed the will in the exercise of the petitioner's free will.

(5) A statement identifying the petitioner, and all persons believed by the petitioner to have an interest in the proceeding, including, for any interested parties who are minors, information regarding the minor's appropriate representative.

(b) The petitioner shall file a copy of the will or codicil with the petition and tender the original will or codicil at the hearing as provided in G.S. 28A-2B-1(b). If an order is entered declaring the will or codicil to be valid, the court shall affix a certificate of validity to the will or codicil. (2015-205, s. 2; 2019-178, s. 1(b).)

§ 28A-2B-4. Declaration by court; bar to caveat.

(a) If the court enters a judgment declaring a will or codicil to be valid, such judgment shall be binding upon all parties to the proceeding, including any persons represented in the proceeding pursuant to the provisions of G.S. 28A-2-7, and no party bound by the judgment shall have any further right to, and shall be barred from filing, a caveat to the will or codicil once that will or codicil is entered into probate following the petitioner's death.

(b) If the court declares a will or codicil to be valid, upon the motion of the petitioner or the court, the court may order that the will or codicil cannot be revoked and that no subsequent will or codicil will be valid unless the revocation or the subsequent will or codicil is declared valid in a proceeding under this Article. If the court enters such an order, any subsequent revocation of the will or codicil not declared valid in a proceeding under this Article shall be void and any subsequent will or codicil not declared valid in a proceeding under this Article shall be void and shall not be admitted to probate.

(c) If a will or codicil judicially declared valid is revoked or modified by a subsequent will or codicil, nothing in this section shall bar an interested person from contesting the validity of that subsequent will or codicil, unless that subsequent will or codicil is also declared valid in a proceeding under this Article in which the interested person was a party. If a will or codicil judicially declared valid is revoked by a method other than the execution of a subsequent will or codicil, nothing in this section shall bar an interested person from contesting the validity of that revocation, unless that revocation is also declared valid in a proceeding under this Article in which the interested person was a party.

(d) Nothing in this Article shall preclude a party from seeking relief from a judgment pursuant to Rule 60 of the North Carolina Rules of Civil Procedure, including, without limitation, for fraud upon the court. (2015-205, s. 2; 2021-53, s. 1.4A.)

§ 28A-2B-5. Confidentiality.

Following the entry of a judgment, a party to the proceeding may move that the contents of the file be sealed and kept confidential, and upon such motion, the clerk shall seal the contents of the file from public inspection. The contents of the file shall not be released except by order of the clerk to any person other than:

(1) The petitioner named in the petition.
(2) The attorney for the petitioner.
(3) Any court of competent jurisdiction hearing or reviewing the matter.

For good cause shown, the court may order the records that are confidential under this section to be made available to a person who is not listed in this section. Following the petitioner's death, a sealed file shall be unsealed upon the request of any interested person for the purpose of probate or other estate proceedings. (2015-205, s. 2.)

§ 28A-2B-6. Costs and attorneys' fees.

Costs, including reasonable attorneys' fees, incurred by a party in a proceeding under this Article shall be taxed against any party, or apportioned among the parties, in the discretion of the court, except that the court shall allow attorneys' fees for the attorneys of a party contesting the proceeding only if the court finds that the party had reasonable grounds for contesting the proceeding. (2015-205, s. 2.)

N.C. Gen. State.
Article 4C - Judicial Establishment of Validity of a Revocable Trust.

§ 36C-4C-1. Proceedings for validity of a revocable trust.

A settlor may commence a judicial proceeding to establish the validity of a revocable trust pursuant to this Article. (2021-53, s. 1.1.)

§ 36C-4C-2. Establishing validity of a revocable trust before death.

(a) During the settlor's lifetime, any settlor of a revocable trust who is a resident of North Carolina may commence a judicial proceeding seeking a judicial declaration that the trust is valid.

(b) The petition shall be filed with the Superior Court Division of the General Court of Justice. At the hearing, the petitioner shall produce the evidence necessary to establish that the revocable trust, including any existing amendments thereto, is valid and enforceable under its terms, subject only to a subsequent amendment or revocation of the revocable trust. Civil summonses shall be issued to those interested persons identified in the settlor's petition, and such

parties shall be served with a copy of the summons and petition as provided in Rule 4 of the Rules of Civil Procedure.

(c) The petition filed to determine the validity of a revocable trust may also join as an additional claim a request for a judicial declaration that the petitioner's will or codicil is valid as provided in Article 2B of Chapter 28A of the General Statutes and, notwithstanding G.S. 28A-2B-1(b), the joined action shall be heard in the Superior Court Division of the General Court of Justice as provided in this Article.

(d) Failure to use the procedure authorized by this Article shall not have any evidentiary or procedural effect on any future proceedings, including trust proceedings, civil actions, and estate proceedings.

(e) For purposes of this Article only, a "petitioner" is a person who requests a judicial declaration that confirms the validity of that person's revocable trust. (2021-53, s. 1.1.)

§ 36C-4C-3. Venue.

The venue for a petition under this Article shall be as provided in G.S. 36C-2-204. (2021-53, s. 1.1.)

§ 36C-4C-4. Contents of petition for revocable trust validity.

(a) Petition. – A petition requesting an order declaring that a petitioner's revocable trust is valid shall be verified and shall contain the following information:

(1) A statement that the petitioner is a resident of North Carolina and specifying the county of the petitioner's residence.

(2) Allegations that the revocable trust was prepared and executed in accordance with North Carolina law and a statement that the revocable trust was created with intent to create the revocable trust.

(3) A statement that the petitioner had capacity to create a revocable trust at the time the trust was created.

(4) A statement that the petitioner was free from undue influence and duress and executed the revocable trust in the exercise of the petitioner's free will.

(5) A statement identifying the petitioner, and all persons believed by the petitioner to have an interest in the proceeding, including, for any interested parties who are minors, information regarding the minor's appropriate representative.

The petitioner shall attach a copy of the revocable trust and any amendments then in effect to the petition. If an order is entered declaring the revocable trust to be valid, the petitioner shall tender the original revocable trust and any amendments then in effect at the hearing, and the

court shall affix a certificate of validity to such revocable trust and amendments, if any. (2021-53, s. 1.1.)

§ 36C-4C-5. Declaration by court; bar to contesting validity of trust.

(a) If the court enters a judgment declaring a revocable trust to be valid, such judgment shall be binding upon all parties to the proceeding, including any persons represented in the proceeding, pursuant to the provisions of Article 3 of Chapter 36C of the General Statutes, and no party bound by the judgment shall have any further right to, and shall be barred from filing, a challenge to the validity of the revocable trust once that trust becomes irrevocable.

(b) If the court declares a revocable trust to be valid, upon the motion of the petitioner or the court, the court may order that the trust cannot be revoked and that no subsequent revocable trust or amendment to the validated trust will be valid unless the revocation or the subsequent amendment to the validated trust is declared valid in a proceeding under this Article. If the court enters such an order, any subsequent revocation of the trust not declared valid in a proceeding under this Article shall be void, and any subsequent trust or amendment to the validated trust not declared valid in a proceeding under this Article shall be void.

(c) If a revocable trust judicially declared valid is revoked or modified by a subsequent revocable trust or amendment, nothing in this section shall bar an interested person from contesting the validity of that subsequent trust or amendment, unless that subsequent trust or amendment is also declared valid in a proceeding under this Article in which the interested person was a party. If a trust or amendment to a trust judicially declared valid is revoked by a method other than the execution of a subsequent trust, nothing in this section shall bar an interested person from contesting the validity of that revocation, unless that revocation is also declared valid in a proceeding under this Article in which the interested person was a party.

(d) Nothing in this Article shall preclude a party from seeking relief from a judgment pursuant to Rule 60 of the North Carolina Rules of Civil Procedure, including, without limitation, for fraud upon the court. (2021-53, s. 1.1.)

§ 36C-4C-6. Confidentiality.

(a) Following the entry of a judgment, a party to the proceeding may move that the contents of the file be sealed and kept confidential, and upon such motion, the court shall seal the contents of the file from public inspection. The contents of the file shall not be released except by order of the court to any person other than the following:

(1) The petitioner named in the petition.
(2) The attorney for the petitioner.
(3) A court of competent jurisdiction hearing or reviewing the matter.

(b) For good cause shown, the court may order the records that are confidential under this section to be made available to a person who is not listed in this section. Following the petitioner's death, a sealed file shall be unsealed upon the request of any interested person for the purpose of other estate proceedings. (2021-53, s. 1.1.)

South Carolina Bar
Continuing Legal Education Division

Income Tax Planning Utilizing Irrevocable Trusts and Other Estate Planning Tools

Jordan Goewey
David Thompson

Income Tax Planning is the New Estate Planning

Presented by David A. Thompson and Jordan S. Goewey

1

Introduction

- Higher estate tax exemptions through the passing of the Tax Cuts and Jobs Act (2017) and the One Big Beautiful Bill Act (2025) reduce transfer tax concerns.
- Tax planning in the estate planning context should focus on income tax optimization.
- Managing basis, limiting income tax exposure and finding income tax rate arbitrage opportunities are now central strategies.

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The Basics of Basis

- Basis represents capital investment for tax purposes.
- Income tax applies to true economic gain, not return of capital.
- Adjustments occur through depreciation, improvements, etc.

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Basis Examples

- Example 1:
  - In Year 1, Taxpayer purchases a piece of equipment for $10,000.
  - During Years 1 through 10, the equipment made Taxpayer $2,000 per year in profits.
  - During Years 1 through 10, the equipment is fully depreciated on a straight-line basis (i.e., Taxpayer claims $1,000 per year in depreciation deductions).
  - In Year 10, Taxpayer sells the equipment for $5,000.
- Example 2:
  - Taxpayer purchases residential property for $300,000. The property is not Taxpayer's primary residence.
  - In year 2, Taxpayer builds on a new room for $80,000.
  - In year 5, Taxpayer replaces the roof for $20,000.
  - In year 10, Taxpayer sells the property for $800,000.

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Basis Adjustments

- Internal Revenue Code § 1014
- FMV basis at death eliminates lifetime appreciation from taxation.
- Historically, estate taxes were a "backstop."
- Higher estate tax exemptions may operate as a "coupon" providing free basis.
- Consider: intentional inclusion of appreciated assets where beneficial.

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Example 3

To gift or not to gift?

- Client purchased property 20 years ago for $200,000, which is now worth $1 million.
- Client is 80 years old, average health, and has a net worth of approximately $5 million.
- Client ultimately wants the property to go to Child, and thinks it may be "simpler" to transfer the property now.

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Benefits of Holding Appreciated Assets until Death

- Retaining low-basis property until death often maximizes tax efficiency.
- Beneficiary receives full step-up and minimizes capital gains.
- Modern planning may require discouraging unnecessary lifetime gifting.

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Example 4

What type of power of appointment?

- Client is a beneficiary of a trust created by Father.
- The trust holds assets worth $3 million, with basis of just $500,000. Client's assets outside of the trust are worth $2 million.
- Client has a testamentary power of appointment.

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General Powers of Appointment

Internal Revenue Code § 2041

A general power of appointment ("GPOA") grants the powerholder the authority to appoint to:

i. The powerholder;

ii. The powerholder's creditors; or

iii. The creditors of the powerholder or the powerholder's creditors.

Property subject to a GPOA is includible in the powerholder's gross estate under § 2041(a)(2).

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Example 4, Part 2

What type of power of appointment?

- Client is a beneficiary of a trust created by Father.
- The trust holds assets worth $3 million, with basis of just $500,000. Client's assets outside of the trust are worth $2 million.
- Client has a testamentary power of appointment exercisable in favor of Father's descendants, but not in favor of Client, Client's estate, Client's creditors or the creditors of Client's estate.

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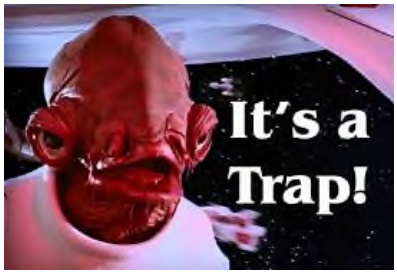
Delaware Tax Trap

- Internal Revenue Code § 2041(a)(3)
- Estate inclusion is caused for a powerholder who exercises a nongeneral power of appointment "by **creating another power of appointment** which **under the applicable local law** can be validly exercised so as to **postpone the vesting** of any estate or interest in such property, **or suspend the absolute ownership** or power of alienation of such property, **for a period ascertainable without regard to the date of the creation of the first power.**"



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Springing the Trap

Example 4, Part 2 (continued)

- Client is a beneficiary of a trust created by Father.
- The trust holds assets worth $3 million, with basis of just $500,000. Client's assets outside of the trust are worth $2 million.
- Client has a testamentary power of appointment ("POA") exercisable in favor of Father's descendants, but not in favor of Client, Client's estate, Client's creditors or the creditors of Client's estate.
- Client executes a will which exercises the POA to:
  - Appoint the appreciated assets of the trust to a separate, testamentary trust for the benefit of Child.
  - The testamentary trust grants child a full withdrawal power of trust assets (i.e., a presently exercisable general power of appointment, or "PEG").
  - The appointed assets are included in Client's estate under § 2041(a)(3).

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Downsides of the Trap

What if Child has issues with finances or compulsive behaviors?

- Granting Child a full withdrawal power may be risky.
- May need to consider other alternatives or sacrifice the potential basis planning.
  - Don't let the tax tail wag the dog.
- Note: Some practitioners have argued that it is possible to trigger the trap without granting a PEG in states like SC.

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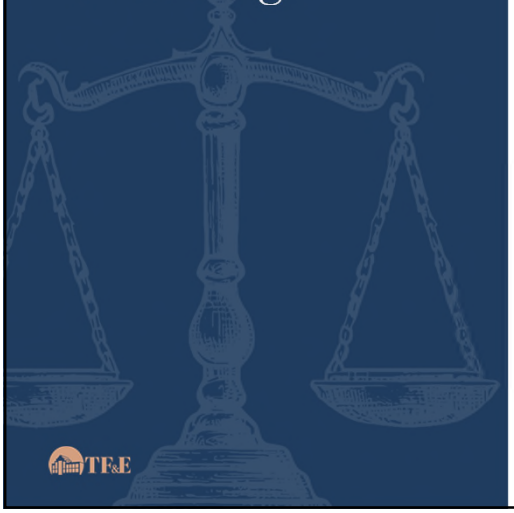
Basis Planning through Decanting



- SC Code § 62-7-816A(a)
  - Unless the terms of the instrument expressly provide otherwise, a **trustee with the discretion to make distributions of principal or income** to or for the benefit of one or more beneficiaries of a trust, the original trust, **may exercise that discretion by appointing all or part of the property subject to that discretion in favor of another trust** for the benefit of one or more of those beneficiaries, the second trust. This power **may be exercised without the approval of a court**, but court approval is necessary if the terms of the original trust expressly prohibit the exercise of such power or require court approval.
- SC Code § 62-7-816A(d)(7)
  - The **second trust may confer a power of appointment upon a beneficiary of the original trust** to whom or for the benefit of whom the trustee has the power to distribute principal or income of the original trust. **The permissible appointees of the power of appointment conferred upon a beneficiary may include persons who are not beneficiaries of the original or second trust.**
- Client could consider having an independent trustee decant the trust to grant Client a GPOA.
- Consider the impact of CCA 202352018.

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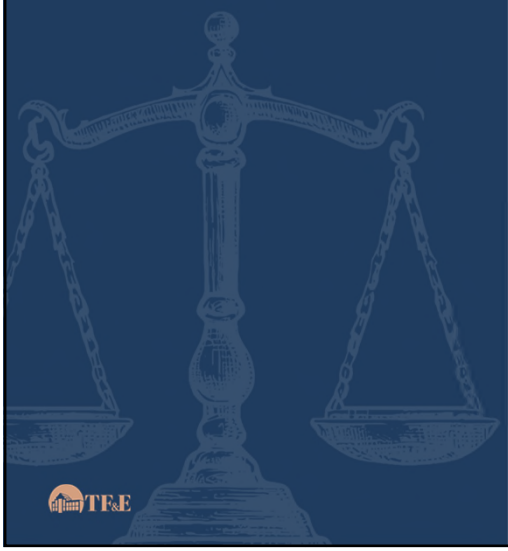
Example 5



- Client is the beneficiary of a trust created by Client's deceased spouse upon spouse's death 4 years ago.
- The trust assets were worth $1 million as of spouse's date of death, but have grown to $1.5 million.
- Trustee is required to distribute all income to Client at least annually and no distributions can be made to any other person during Client's lifetime.
- No federal estate tax return was filed for spouse.

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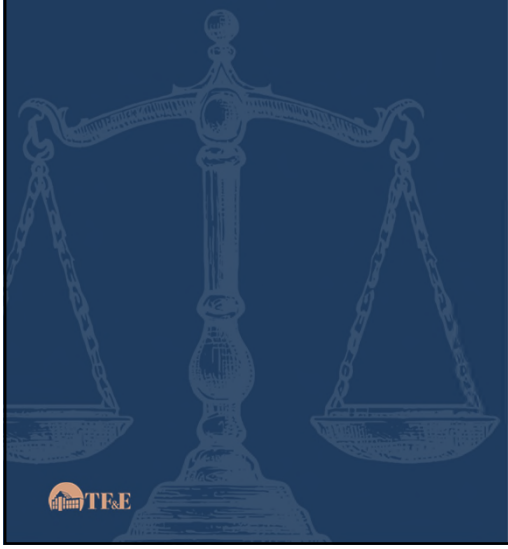
QTIP Election



- Internal Revenue Code § 2056(b)(7)
- Internal Revenue Code § 2044 includes QTIP assets in the surviving spouse's gross estate.
- Treas. Reg. § 20.2056(b)-7(b)(4)(i)
  - A **QTIP election** has to be made on "the last estate tax return filed by the executor on or before the due date of the return, including extensions or, **if a timely return is not filed, the first estate tax return filed by the executor after the due date.**"
- 5 year rule under Rev. Proc. 2022-32

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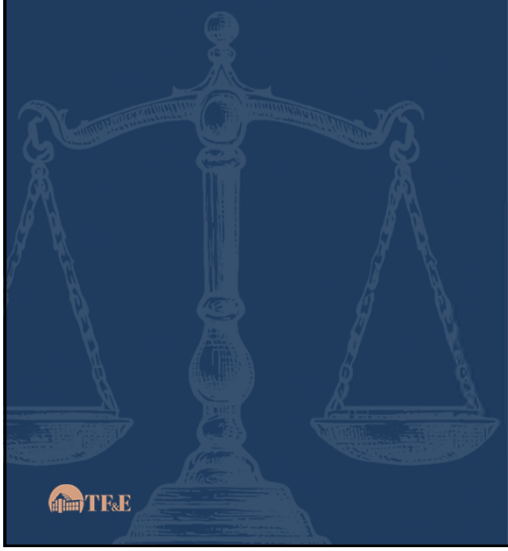
Example 6



- Client owns a beach house worth $3 million, with a basis of $1 million. Client has long wanted to sell the beach house, but is reluctant to do so due to the capital gains impact.
- Client no longer uses the beach house, but Client's Child, a college student, frequents it during the summer.
- Client has also considered making a substantial gift to Child in the future, perhaps even the beach house itself.
- Client's mother is 95 and has a very modest estate.

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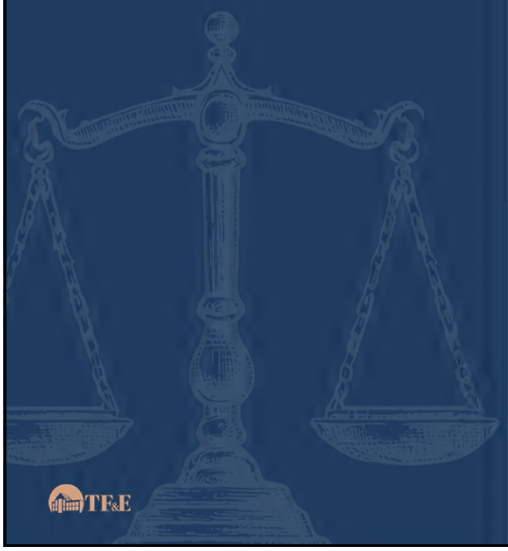
Upstream Basis Planning



- Internal Revenue Code § 1014(b)(9)
  - "property acquired from the decedent by reason of death, form of ownership, or other conditions **(including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate**"
- Client could consider transferring the property to an irrevocable trust for Child's benefit and granting Client's mother a GPOA over the trust assets.
- Upon mother's death, assets subject to the GPOA would be included in her estate and receive a basis step up.

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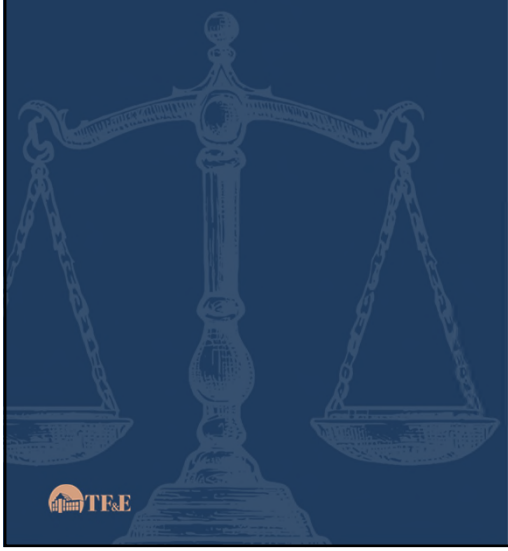
Upstream Basis Planning



Other considerations:

- Include mother as a trust beneficiary?
- Limit the GPOA to creditors of mother's estate? Require consent of a nonadverse party?
- Can the trust be "silent"?
- What if mother is incapacitated?
- What if mother had a larger estate and there was concern that the GPOA could cause an estate tax to be incurred?

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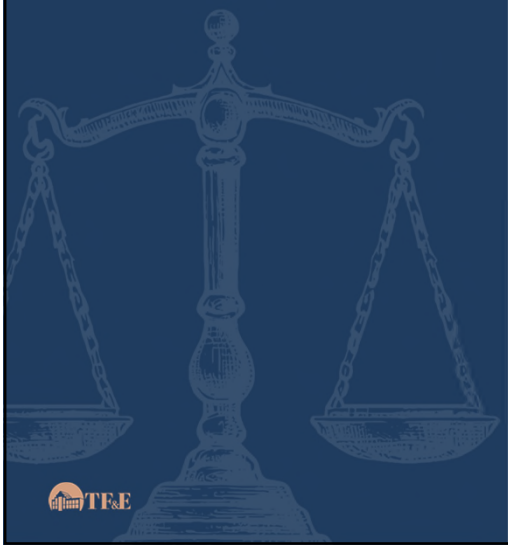
Example 7



- Husband (H) and Wife (W) are 70 years old and have a combined net worth of $25 million. W has a brokerage account with a total value of $15 million, with $10 million of basis.
- H and W have considered a Spousal Lifetime Access Trust and other estate tax techniques, but are wary of missing out on a step-up in basis if they transfer assets out of their estates during life.
- W's sister is 78 and unhealthy. Her only assets are a small checking account and modest residence. W assists monetarily with her care.

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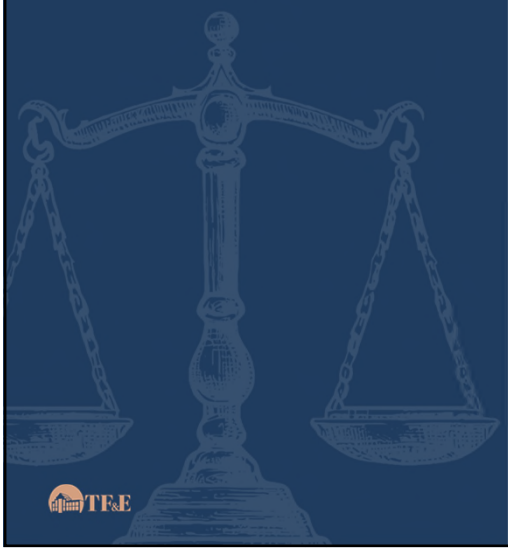
Upstream Basis Planning (cont.)



- W could consider setting up a SLAT for H's benefit and funding it with the $15 million in marketable securities.
- W could include her sister as a support beneficiary and grant her a contingent GPOA.
- The GPOA should:
  - Be limited to creditors of the powerholder's estate.
  - Require the consent of a nonadverse party.
  - Apply only to appreciated assets.
  - Apply only to the extent of the powerholder's available estate tax exemption.
- Consider designing a formula for the contingent GPOA.
- See outline for references to Optimal Basis Increase Trusts (OBITs), Accidentally Perfect Grantor Trusts, Upstream Power of Appointment Trusts (UPSPATs)

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Nongrantor Trust Planning

- For many years, grantor trust planning has been dominant.
- Rev. Rul. 2004-64
- Benefits of the income tax "burn"
- Higher estate tax exemptions lessens the need for the "bonus" gifting and "burn" effect that comes from grantor carrying the income tax burden.
- Nongrantor trusts can be beneficial (at times) because they are separate taxpayers.

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Minimizing State Income Tax

- If sitused in a state with low or no state income tax, a nongrantor trust may be able to avoid state income tax.
  - Works particularly well with portfolio income.
  - Sourced income may run into conflicts of law issues.
- Federal tax rates for trusts are high, so perhaps only beneficial for high earners.
  - Also consider a "sprinkle" or "pot" trust with multiple beneficiaries who may be in lower tax brackets.
- Incomplete Gift Nongrantor Trusts (INGs)
  - Benefit: Grantor retains some control
  - Downside: Relying on PLRs

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Qualified Small Business Stock

Background on Section 1202

- Initially introduced in 1993 and various improvements since (easier to qualify and better benefits)
- Only domestic C corporation stock qualifies
- Must be original issuance—intended to incentivize founders and early investors
- Must be an active business, and certain service businesses are excluded (including lawyers)
- Must avoid disqualifying redemptions

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Qualified Small Business Stock

Stock Issuance Date	QSBS Gain Exclusion
Aug. 11, 1993 – Feb. 18, 2009	50% (for stock held at least 5 years)
Feb. 19, 2009 – Sept. 27, 2010	75% (for stock held at least 5 years)
Sept. 28, 2010 – July 3, 2025	100% (for stock held at least 5 years)
July 4, 2025 – present	50% (for stock held at least 3 years) 75% (for stock held at least 4 years) 100% (for stock held at least 5 years)

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QSBS Limits

Per Taxpayer, Per Issuer Limits

- Prior to OBBBA (July 4, 2025), the greater of:
  - $10 million; or
  - 10 times adjusted basis in QSBS sold during the taxable year.
- OBBBA increased the dollar limit to $15 million.
  - Original issuance must be after July 4, 2025.
- Due to these limits being per taxpayer, nongrantor trusts present a "stacking" opportunity

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Example 8

- Client is the founder of Lawyer Language Model, Inc., an AI service that will likely eliminate the need for lawyers worldwide.
- Client's shares of LLM (all of which were issued on July 5, 2025, when LLM was incorporated) recently appraised at $45 million, and Client's basis is essentially zero.
- Client is married and has two children.

QSBS Stacking

- Client could set up and fund nongrantor trusts for the benefit of both children.
- Each nongrantor trust could be funded with $15 million of QSBS (assuming Client's spouse is willing to split gifts on a gift tax return).
- The nongrantor trusts will receive a tacked-on holding period with respect to the QSBS.
- Once the 5-year holding period is attained, all of the QSBS could be sold and $45 million of gain could be excluded.
- Assuming the trusts are completed gift trusts, the usual benefits of removing $30 million from Client's estate before it appreciates in value are also achieved.

Limitations on Stacking

- Stacking cannot be achieved with grantor trusts because they are not separate taxpayers.
- Stacking cannot be achieved through sales because the shares must be original issuance.
- Section 643(f) limits the ability to create multiple trusts for the benefit of the same beneficiaries.
- Beware of the assignment of income doctrine if the transfer to trust is close-in-time to the sale of the company.

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SALT Stacking

- OBBBA increased the limitation on the deduction for state and local taxes (SALT) from $10,000 to $40,000
- Theoretically, a high earner could transfer income-generating assets to multiple nongrantor trusts to "stack" SALT deductions.
- Though the increase from $10,000 to $40,000 per deduction makes this strategy more attractive than it was pre-OBBBA, the benefit is still somewhat limited and may not be worth the cost of administration.
- Also note the increased SALT cap expires in 2029. Perhaps this strategy would warrant more attention if made permanent.

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Any Questions?

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Income Tax Planning is the New Estate Planning

South Carolina Bar Convention
January 23, 2026

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Income Tax Planning is the New Estate Planning[1]

1. Introduction

The passage of the Tax Cuts and Jobs Act of 2017 and subsequent legislation, including the permanent increase in the estate tax exemption under the legislation colloquially referred to as the One Big Beautiful Bill Act (the "OBBBA"), has shifted the estate planning landscape for practitioners.[2] For decades, estate planning was dominated by strategies aimed at reducing or avoiding transfer taxes. With exemptions now so high that only a fraction of estates face federal estate tax exposure, the emphasis for planners has necessarily turned to income tax planning. The central question for modern estate planners for many clients is less about how to keep assets out of the client's taxable estate and more about how to mitigate ongoing income tax burdens, maximize deductions, and enhance basis step-up opportunities.

These materials explore practical techniques for managing income tax basis in the post-OBBBA environment. We examine methods for intentionally including appreciated assets in an individual's taxable estate to capture a basis step-up without incurring transfer tax liability, including the use of general powers of appointment, the Delaware Tax Trap, and "upstream basis" planning. Additionally, we discuss how non-grantor trust structures can facilitate state income tax savings and allow for Qualified Small Business Stock ("QSBS") stacking, allowing multiple taxpayers to benefit from exclusions under Section 1202 of the Internal Revenue Code.

2. Income Tax Basis and Estate Planning

2.a. Basis as Capital Investment in Property

The easiest way to illustrate the concept of income tax basis on a basic level might be through a straightforward example. If a taxpayer purchases stock for $10,000 and later sells it for $15,000, only the $5,000 gain constitutes income. The $10,000—i.e., the amount by which the sale proceeds are reduced for purposes of calculating the gain—is called the "basis" of the stock in the taxpayer's hands. The basis in this example ($10,000) also equals the initial purchase price of the stock, which is why basis is commonly understood to represent the cost of an asset. However, to understand the logic

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[1] These materials were prepared with the assistance of Justin A. Manson (UNC School of Law class of 2026) and Meredith G. Watson (Alabama School of Law class of 2026).

[2] All tax and related provisions referenced herein reflect the law as modified by the OBBBA, which was enacted in 2025 and made permanent several key provisions of the Tax Cuts and Jobs Act of 2017. While OBBBA provides welcome clarity for many taxpayers, it represents a significant and recent legislative development. Accordingly, readers should exercise caution and consult updated guidance as administrative interpretations and technical corrections emerge. Some figures and assumptions herein may reflect pre-OBBBA law or be affected by future regulatory or judicial developments.

behind various basis rules imposed by the Internal Revenue Code, some of which are discussed in these materials, it is necessary to attain a deeper understanding of what basis is.

One of the foundational income tax principles is that the proper measure of income for tax purposes is the "accretion" of wealth, not mere cash receipts.[3] This means that the proper tax base of income tax should capture only true economic gain rather than the mere return of capital already invested. When a taxpayer sells property, the income should be limited to the appreciation in value, not the entire proceeds, because the portion attributable to the original investment represents after-tax dollars that should not face taxation again. This is also known as the "recovery of capital" doctrine. The doctrine protects from taxation the portion of investment receipts representing the amount initially invested, on the theory that the taxpayer's initial (or subsequent) investment is merely being returned to the taxpayer.

In the Internal Revenue Service's own words, basis is the amount of taxpayer's "capital investment in property for tax purposes."[4] Consider the following example:

- In Year 1, Taxpayer purchases a piece of equipment for $10,000.
- During Years 1 through 10, the equipment made Taxpayer $2,000 per year in profits.
- During Years 1 through 10, the equipment is fully depreciated on a straight-line basis (i.e., Taxpayer claims $1,000 per year in depreciation deductions).
- In Year 10, Taxpayer sells the equipment for $5,000.

How much accretion of wealth did Taxpayer achieve? Without considering any time value of money, the answer is $15,000 because Taxpayer invested $10,000 and made $25,000 in the end ($20,000 from annual profits and $5,000 from sale of the equipment). The income tax system should therefore recognize $15,000 as income in one way or another.

If the basis of the equipment were to be understood simply as its cost ($10,000), however, the amount of income for tax purposes would be only $5,000 ($20,000 of profits, less $10,000 of depreciation deductions, less a $5,000 loss from sale of the equipment). The discrepancy is caused by the depreciation deductions (or, as explained below, the lack of corresponding basis adjustments). Under Section 167 of the Internal Revenue Code, a depreciation deduction is allowed as "a reasonable allowance for the

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[3] *See* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 Harv. L. Rev. 925 (1967).

[4] Topic No. 703, Basis of Assets, Internal Revenue Serv., https://www.irs.gov/taxtopics/tc703 (last visited Dec. 8, 2025)

exhaustion, wear and tear." In a sense, the tax system assumes that the value of the asset in question declines over its useful life in a linear manner, or that the taxpayer loses his or her investment in the asset in such manner, and allows the taxpayer to take a deduction for the loss. Another way to look at this is that, of the $2,000 Taxpayer makes in each of Years 1 through 10, $1,000 is being treated as a tax-free recovery of capital because Taxpayer essentially exhausted or depleted 10% of the equipment in producing that $1,000.[5]

If basis were to be understood as the taxpayer's capital investment in property, and depreciation deductions as recovery of capital, then it logically follows that the basis of property must be decreased by the amount of depreciation, which is exactly what Section 1016(a)(2) of the Internal Revenue Code provides. Applied to the example above, the amount of income for tax purposes would be calculated at $15,000 ($20,000 of profits, less $10,000 of depreciation deductions, plus a $5,000 gain from sale of the equipment), which equals the amount of accretion of Taxpayer's wealth.

Similarly, I.R.C. § 1016(a)(1) provides that proper adjustment must be made to basis for any expenditure properly chargeable to a capital account. Under Treas. Reg. § 1.263(a)-3, an amount must generally be capitalized if it constitutes a betterment to a unit of property, restores a unit of property, or adapts a unit of property to a new or different use. For example, if a taxpayer purchases a piece of residential property for $300,000 and invests an additional $25,000 to replace the roof, the basis of the property as a whole should be adjusted upward to reflect the increase in the taxpayer's capital investment in the property. If no adjustment is made, the taxpayer will be taxed again on his $25,000 investment when the property is sold.

2.b. Step-Up in Basis Under Section 1014

Arguably, the most dramatic basis adjustment rule in the Internal Revenue Code is found in Section 1014. Section 1014 of the Internal Revenue Code ("Section 1014") provides that the basis of property acquired from a decedent shall be the fair market value of the property at the date of death.[6] This "step-up in basis"[7] means that death artificially increases the amount of capital investment in property (that is recoverable tax-free), even if no additional investment is actually made, and permanently excludes appreciation occurring during the decedent's lifetime from the income tax base. For example, an heir who inherits property worth $1 million that the decedent purchased for $200,000 receives

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[5] This is why tax professionals sometimes call depreciation deductions "cost recovery."

[6] In certain instances, the personal representative may elect to use the alternate valuation date under Internal Revenue Code § 2032 (in general, six months after the date of death). For simplicity, the date of death will be used as the valuation date in these materials.

[7] Alternatively, the basis may also be "stepped-down" under Section 1014 if property has declined in value.

a basis of $1 million, not $200,000. If the heir subsequently sells the property for $1 million, no capital gain is recognized. The result is that $800,000 of appreciation—gain that would have been taxable had the decedent sold the property during life—escapes income taxation entirely.

It is often said that the basis step-up under Section 1014 represents one of the biggest tax loopholes.[8] For high-net-worth families and individuals, however, the basis step-up has historically not functioned as a truly cost-free benefit because the federal estate tax has served as a significant backstop to Section 1014. The estate tax imposed a substantial price on transferring appreciated assets to heirs, effectively offsetting some of the tax benefits created by the basis step-up mechanism. However, the American Taxpayer Relief Act of 2012 increased the estate tax exemption to $5 million per person (adjusted for inflation), making the Section 1014 basis step-up truly free for a much larger group of people. Of course, the effect of higher exemption amounts is even more pronounced after the passage of the Tax Cuts and Jobs Act of 2017 and the OBBBA, with the estate tax exemption for 2026 being $15 million per person.

As some practitioners put it,[9] the applicable exclusion amount can now be thought of as a "coupon" that taxpayers can use to obtain free basis, meaning that the tax cost of obtaining the basis increase through estate inclusion is zero or near-zero because no estate tax is actually paid on assets within the taxpayer's exemption amount. Under this framework, the applicable exclusion amount can be strategically deployed not primarily to avoid transfer taxes—a goal that for many taxpayers has become moot due to the value of their assets falling well below exemption thresholds—but rather to secure a basis step-up by deliberately including low-basis assets in the decedent's taxable estate.

2.c. Strategic Use of One's Own "Coupon"

2.c.i. Holding Appreciated Assets Until Death

In the next few sections, various versions of the following hypothetical will be used to illustrate the relevant planning techniques.

Example 2.c.i. Client, a widower, purchased a piece of property 20 years ago for $200,000. The property is now worth $1 million. Client has $5 million of other assets of his own and $15 million of available estate tax exemption. Client plans to leave the

[8] *See, e.g.*, Bridget J. Crawford, Crystal Lichtenberger, Kaitlin Maguire & Gigi McQuillan, *Step-Up in Basis: Policy Perspectives on a Longstanding Tax Loophole*, 7 Geo. Wash. Bus. & Fin. L. Rev. 54 (2024).

[9] *See, e.g.*, Edwin P. Morrow III, *The Optimal Basis Increase and Income Tax Efficiency Trust: Exploiting Opportunities to Maximize Basis, Lessen Income Taxes and Improve Asset Protection for Married Couples after ATRA (Or: Why You'll Learn to Love the Delaware Tax Trap)* (Jan. 1, 2016) (unpublished manuscript), https://ssrn.com/abstract=2436964.

property to Child upon death. Client approaches you and asks whether he should go ahead and transfer the property to Child during life.

In this example, Client should likely be advised against the lifetime transfer. The simplest way to use the exemption amount as a coupon to obtain free basis is to do nothing and hold appreciated assets until death. An individual can simply maintain ownership of appreciated property throughout life and allow it to pass upon death, thereby triggering the basis adjustment mechanism under Section 1014. When the property is inherited, its basis steps up to its fair market value as of the date of death, and any subsequent sale by the beneficiary is taxed only on gains accruing after the decedent's death.

Although this "strategy" is fundamentally passive, and thus may hardly be one, it is worth elucidating the idea because, like Client, people often go out of their way to transfer assets to their beneficiaries before they die. They tend to believe that transferring their assets during life would make things simpler for their surviving family members, which may well be true in some cases. Also, it is worth noting that lifetime gifting was the standard advice when the estate tax exemption was much lower, because (as explained in Section 2.d.i below) it freezes the value of the gifted asset for transfer tax purposes. However, as explained above, a step-up in basis under Section 1014 can confer significant tax benefits to the beneficiaries; clients who contemplate lifetime gifting must always be advised of the fact that the assets being transferred out of their estate during life would not receive a basis step-up when they die.

2.c.ii. Causing Estate Inclusion of Existing Trusts

2.c.ii.A. General Power of Appointment

Example 2.c.ii.A. Client also has a trust that was created by his father (the "Trust"). The Trust holds various assets worth $3 million in total with low bases. Unless Client exercises a testamentary[10] power of appointment granted to him in the instrument creating the Trust (the "POA"), the Trust passes to Child upon Client's death.

The same reasoning that favors including the $1 million property in Client's estate in the previous example also supports causing the Trust to be included in Client's estate. Ordinarily, a trust is not included in a beneficiary's estate if the beneficiary is, like Client, a life tenant of the trust. An important exception to this general rule is where the beneficiary holds a "general power of appointment."

[10] This means that the power of appointment is exercisable through Client's will.

Under I.R.C. § 2041(b)(1), a general power of appointment is a legal device that gives a person (the "powerholder") the authority to designate who will receive certain property, with the critical feature being that the powerholder can appoint the property to any of the following four classes of potential appointees: (i) the powerholder, (ii) the powerholder's estate, (iii) the powerholder's creditors, or (iv) the creditors of the powerholder's estate. This broad authority distinguishes general powers from special or limited powers of appointment, which restrict potential appointees by excluding the four classes described above. Under I.R.C. § 2041(a)(2), property subject to a general power of appointment held at death is includible in the decedent's gross estate.

Therefore, in this example, it will need to be determined whether the POA is a general power of appointment before any planning technique is considered. Also, note that Client could unintentionally be deemed to hold a general power if Client holds certain other powers over the Trust, such as if: (i) Client serves as the trustee of the Trust, or has unrestricted power to remove the trustee and appoint himself,[11] **and** (ii) the trustee has the distribution power that (A) is not limited to an ascertainable standard (e.g., "health, education, support, or maintenance")[12] and (B) can be used to discharge the trustee's legal obligation of support[13]. A well-drafted trust instrument will include a savings clause that carves out these types of "tainted" powers whenever they can be attributed to the beneficiary. Note that the mere existence of the general power causes estate inclusion whether or not the powerholder exercises the power.[14]

In some cases, estate planners use contingent general powers of appointment with formulas defined based on the size of the powerholder's taxable estate to intentionally cause estate inclusion, thereby obtaining a basis step-up under Section 1014 without triggering estate tax liability. This planning technique has gained significant traction following the dramatic increases in the federal estate tax exemption. A formula general power of appointment is typically drafted to limit the scope of the power to the largest portion of trust property that can be included in the powerholder's estate without causing or increasing federal estate tax. PLR 202206008 describes one example of such a provision:

> "[The relevant provision of the trust agreement] grant[s] Child a testamentary general power of appointment to appoint a 'Defined Portion' of Trust B principal to Child's estate. The term 'Defined Portion' means the

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[11] *See* Treas. Reg. § 20.2041-1(b)(1).

[12] I.R.C. § 2041(b)(1)(A).

[13] Treas. Reg. § 20.2041-1(c)(1).

[14] That said, it is worth noting that the specific trigger for basis step-up under Section 1014 differs depending on whether the general power of appointment is exercised or simply lapses. Section 1014(b)(9), the trigger for lapses of general powers, has a few additional limitations which are outside of the scope of these materials.

> largest portion of Trust B that could be included in Child's federal estate without increasing the total amount of the 'Transfer Taxes' actually payable at Child's death over and above the amount that would have been actually payable in the absence of this provision. The term 'Transfer Taxes' means all inheritance, estate, and other death taxes, plus all federal and state GST taxes, actually payable by reason of Child's death."

This formula likely ensures that the general power applies only to the extent that inclusion will not generate any actual estate tax, effectively capping the includible amount at the powerholder's unused applicable exclusion amount.[15]

Therefore, if the POA is a general power of appointment, or Client is deemed to hold a general power of appointment in one way or another, the Trust will be included in Client's estate and receive a step-up in basis under Section 1014, even if Client does not actively pursue any of the strategies discussed below.

2.c.ii.B. Delaware Tax Trap

If the POA in Example 2.c.ii.A above is not a general power of appointment, Client can consider using the Delaware Tax Trap to cause estate inclusion of the Trust. The Delaware Tax Trap is derived from a provision of the Internal Revenue Code—specifically Section 2041(a)(3)—that was originally designed to prevent wealthy families from avoiding estate taxes in perpetuity. Historically, it was a "trap" to be avoided, but, today, estate planners frequently use it as a tool to intentionally cause estate inclusion. The Code section states that property subject to a power of appointment will be included in the powerholder's gross estate if they exercise the power:

> "by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power."[16]

In other words, if the powerholder uses his or her power to create a new power of appointment that, under local law, resets the clock for rule-against-perpetuities purposes,

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[15] Some commentators argue based on a Tax Court case, *Estate of Kurz v. Commissioner*, 101 T.C. 44 (1993), that a formula general power like this may not be capped as intended because the beneficiary might have some measure of control over the scope of the general power of appointment. *See* Steven B. Gorin, II.H.2.k. Taxable Termination vs. General Power of Appointment vs. Delaware Tax Trap, "Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications" (printed 4/22/2025), available by emailing the author at sgorin@thompsoncoburn.com.

[16] I.R.C. § 2041(a)(3).

the Internal Revenue Service treats the powerholder as the full owner of those assets for estate tax purposes.

At the time Section 2041(a)(3) was enacted, Delaware had a provision in its laws that reset the perpetuities clock in an unusual manner, which is where the name "Delaware Tax Trap" comes from. Notwithstanding the historic purpose, in contemporary practice, the technique mostly involves exercising a limited power of appointment to appoint assets to a new trust that grants the beneficiary a presently exercisable (i.e., lifetime) general power of appointment (a "PEG"). If Client were to employ this strategy, Client would appoint the assets in the Trust to a new trust for the benefit of Child (or some other permitted appointee) over which Child has a PEG. Under the laws of many states, including South Carolina, creating a PEG like this will reset the perpetuities clock and cause inclusion in Client's estate, not just Child's.

An important advantage of this technique is that it is relatively easy to implement. In many cases, the Delaware Tax Trap may be triggered through execution of a codicil that grants a PEG to another person. However, what if the person who will be holding the PEG is financially irresponsible or has a history of substance abuse? Trust decanting, discussed in Section 2.c.ii.C below, can serve as an alternative in such cases.[17]

2.c.ii.C. Decanting

Trust decanting is the distribution of assets from an existing irrevocable trust to a new trust with different terms, exercised under a fiduciary power to "pour" assets into a second trust. When the trustee has broad discretionary distribution authority, many state statutes (including South Carolina's)[18] treat decanting as an exercise of a special power of appointment, allowing significant changes to administrative and, sometimes, beneficial provisions without court involvement or formal amendment.

Unlike the Delaware Tax Trap, decanting itself does not automatically cause estate inclusion, but the new trust's terms can create rights that trigger inclusion; for example, a new general power of appointment. In this type of decanting, a trustee with decanting authority distributes assets from the original trust to a new trust that grants a particular beneficiary a general power (for example, the power to appoint to the beneficiary, the beneficiary's estate, or creditors of either) that did not exist under the first trust. South

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[17] Some commentators argue that it is possible to trigger the Delaware Tax Trap without granting a PEG by using a particular section of the Uniform Statutory Rule Against Perpetuities. See Les Raatz, *USRAP Surprise: Trigger of Delaware Tax Trap*, 43 Est. Plan. 22 (2016) for a detailed discussion. South Carolina has adopted the section of the Uniform Statutory Rule Against Perpetuities in S.C. Code Ann. § 27-6-30(c).

[18] *See* S.C. Code Ann. § 62-7-816A.

Carolina's decanting statute expressly allows the trustee who engages in decanting to confer a power of appointment to the beneficiary.[19]

That said, an important caveat is illustrated by a Chief Counsel Memorandum issued in late 2023. CCA 202352018 addressed a judicial modification of a grantor trust, with beneficiary consent, to add a discretionary tax reimbursement clause for the grantor and concluded that this modification constituted a taxable gift by the beneficiaries to the grantor. The CCA reasoned that adding the tax reimbursement power shifted value from the beneficiaries to the grantor, and beneficiary consent (or even a statutory right to notice and failure to object) would be treated as a relinquishment of a portion of their beneficial interests subject to gift tax under I.R.C. § 2511. In Client's example, granting Client a general power of appointment through decanting may arguably shift some economic benefits from Child to Client, although it would be very difficult (if not impossible) to quantify that economic benefit. Therefore, in theory, the logic of CCA 202352018 can extend to decantings that add a general power of appointment,[20] which will need to be explained to Client and be prepared for before the strategy is implemented.

2.c.ii.D. QTIP Election

Example 2.c.ii.D. Same facts as above, but the Trust was created by Client's predeceased wife under her will. Client's wife died four years ago, and no estate tax return was filed. Client is entitled to all the income from the Trust, payable annually. Client does not have any power of appointment that is exercisable during his lifetime.

Because the Trust in this example was created by Client's wife, and it has not yet been five years since her death, Client can consider making a qualified terminable interest property ("QTIP") election under I.R.C. § 2056(b)(7) instead of employing one of the techniques described above.

When one spouse makes an outright transfer of assets to the other spouse, during life or at death, the transfer generally qualifies for the marital deduction, resulting in no gift tax or estate tax liability.[21] If the transfer is in trust, however, the law regards the property interest given to the other spouse to be "terminable" and the general rule is

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[19] S.C. Code Ann. § 62-7-816A(d)(7).

[20] Others note that if a decanting can be carried out solely by a disinterested trustee, without consent or objection rights for beneficiaries, CCA 202352018's rationale may not apply because there is no beneficiary "transfer" for gift tax purposes. *See* Scott W. Masselli, *Repairing the Broken Trust: Irrevocable Trust Modifications after CCA 202352018*, 44 NAEPC J. Est. & Tax Plan. (2024), https://www.naepcjournal.org/issue/44/irrevocable-trust-modifications-after-ca-202352018/.

[21] I.R.C. §§ 2056, 2523.

reversed; spousal transfers in trust generally do not qualify for the marital deduction.[22] The primary exception to this prohibition against terminable interest is the QTIP election.

When a personal representative makes a valid QTIP election under I.R.C. § 2056(b)(7), the trust property qualifies for the marital deduction in the first spouse's estate. To make the election, the trust needs to meet the two requirements of I.R.C. § 2056(b)(7)(B)(ii). First, the surviving spouse must be entitled to all the income from the property, payable annually or at more frequent intervals. The surviving spouse must have the immediate right to income, and no person can have the discretion to accumulate income or divert it to anyone other than the spouse. Second, no person, including the surviving spouse, can have a power to appoint any part of the property to any person other than the surviving spouse during the surviving spouse's lifetime. The Trust in the example meets both requirements, which makes it eligible for a QTIP election.

Once the QTIP election is made, I.R.C. § 2044 mandates that any property for which the election was made be included in the surviving spouse's gross estate upon their death. While QTIP elections are normally used to defer estate tax until the surviving spouse's death, planners can use this inclusion intentionally to secure a step-up in basis under Section 1014 for the trust assets when the surviving spouse dies.

This method of causing inclusion of spousal trusts has become particularly relevant now that there is a five-year window to file portability returns. Under Reg. § 20.2056(b)-7(b)(4)(i), a QTIP election has to be made on "the last estate tax return filed by the executor on or before the due date of the return, including extensions or, **if a timely return is not filed, the first estate tax return filed by the executor after the due date.**" Also, under Rev. Proc. 2022-32, a portability return can be filed "late" without going through the letter ruling process if it is filed within five years of the date of death. This means that, in situations where a portability return is desired, the personal representative has five years to make the QTIP election. During the five-year period, the personal representative can monitor the size of the surviving spouse's estate relative to the amount of available exemption and determine whether it would be beneficial to include the spousal trust in the surviving spouse's estate by making the QTIP election.

2.d. Use of Someone Else's "Coupon"

2.d.i. Value Freeze

Thus far, the authors have focused on situations where the step-up in basis under Section 1014 is truly free because the amount of available exemption exceeds the amount of taxable estate and, thus, the transfer taxes are not part of the equation in any substantial way. For high-net-worth or ultra-high-net-worth clients, however, who may face estate

[22] I.R.C. §§ 2056(b)(1), 2523(b).

tax liabilities to varying degrees, the traditional strategies designed to move assets out of their estate at the minimum transfer tax cost still hold merit.

The primary function of the estate and gift tax exemption is to shield a certain amount of wealth from federal transfer tax, whether that transfer occurs during life or at death. When the exemption is applied to a specific transfer, that transfer is effectively removed from the estate and gift tax system at that moment. Thus, the key advantage of using the exemption during life, rather than waiting until death, is that it not only excludes the transferred asset itself from estate tax, but also removes all future appreciation on that asset from the transferor's estate. Once the exemption has been used by a completed lifetime gift, the gifted asset is "frozen" at its transfer-date value for the donor's estate and gift tax purposes.

The core economics of a freeze technique can be illustrated through a simple example as follows. If a grantor transfers an asset worth $4 million during life to an irrevocable trust and uses $4 million of the grantor's exemption for such transfer, the asset is now outside the grantor's estate for estate and gift tax purposes, assuming that the grantor has not retained certain rights or interests in the transferred asset or over the trust. If that same asset grows to $6 million by the time of the grantor's death, the entire $6 million remains outside the grantor's estate. Effectively, by transferring the asset during life rather than retaining it until death, the grantor has shifted not only the original $4 million but also the additional $2 million of appreciation out of the estate without using any additional exemption.

The obvious downside of this approach is that the gifted assets will not get a step-up in basis at the grantor's death. However, in many cases where the grantor does not have enough estate and gift tax exemption to cover all of his or her assets, the tradeoff can be worthwhile because the estate tax rate (40%) is generally higher than the capital gains rate (up to 20%).[23]

2.d.ii. Upstream Basis Planning

Example 2.d.ii. Client has significantly more assets of his own and does not have enough estate and gift tax exemption to cover them. He understands that it is not ideal from a basis perspective to transfer the $1 million property to Child during life. However, Client believes that the $1 million property will dramatically increase in value

[23] Note that with respect to high earning South Carolina taxpayers the capital gains rate may be as high as approximately 27.272% (when considering the 3.8% Net Investment Income Tax and state income tax on South Carolina taxpayers (assumed to be approximately 3.472% when considering state capital gains tax rate and the net capital gain deduction)).

before he dies and wishes to get it out of his estate. Client's mother is still living and has a modest estate.

As explained above, it may be advisable to engage in lifetime gifting in this case even though the estate tax benefits will be tempered by the loss of basis step-up. That said, Client should also consider a relatively new planning device the authors refer to as "upstream basis planning." Upstream basis planning uses a structure designed to obtain an income tax basis adjustment for low-basis assets by intentionally causing inclusion of those assets in the estate of a third party with a short life expectancy and available estate tax exemption (an "Upstream Person"), such as Client's mother. Properly structured, upstream basis planning allows a younger-generation client to use the Upstream Person's remaining exemption to secure a step-up in basis upon the Upstream Person's death, without causing estate tax liability or giving control of the assets to the Upstream Person.

Practitioners use a variety of terms to describe these arrangements, including the Optimal Basis Increase Trust,[24] the Accidentally Perfect Grantor Trust,[25] and the Upstream Power of Appointment Trust[26]. Though the terminology varies and the mechanics slightly differ, all share a common objective: to cause appreciated assets to be included in the estate of a third party in a controlled manner so that those assets receive a fair-market-value basis step-up at the Upstream Person's death. Practitioners should consider their client's risk tolerance when selecting an Upstream Person, considering factors such as life expectancy, available exemption amount, and trustworthiness.

In this example, Client may create an irrevocable trust for the benefit of Child. The trust agreement may grant Client's mother a carefully circumscribed testamentary general power of appointment (the "GPOA") over some or all of the appreciated assets in the trust. By virtue of that power, the subject assets will be included in the mother's gross estate under I.R.C. § 2041(a)(2) and will receive a new basis under I.R.C. § 1014(b)(9). The GPOA will be exercisable only with a non-adverse party's consent and formula-limited so that only appreciated assets eligible for a step-up in basis are subject to the GPOA and only to the extent the inclusion will not trigger estate tax. Because inclusion results from the existence of the GPOA, Client's mother need not actually exercise it. The mother may also be included as a secondary beneficiary (and actual distributions will be made to her where appropriate), which will strengthen the argument that the GPOA is bona fide rather than illusory.

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[24] See Edwin P. Morrow III, *The Optimal Basis Increase Trust*, LISI Est. Plan. Newsletter, No. 2080, Mar. 20, 2013.

[25] *See* Mickey R. Davis & Melissa J. Willms, *Estate Planning for Modest Estates: Practical Tools Every Planner Should Know* (58th Ann. Philip E. Heckerling Inst. on Est. Plan., 2024).

[26] *See* Howard M. Zaritsky & Lester B. Law, *Finding Basis—It's Not Always Where You Thought It Was* (53rd Ann. Philip E. Heckerling Inst. on Est. Plan., 2019).

One important limitation to note is that Section 1014(e) denies a step-up in basis where appreciated property is gifted to a decedent within one year of death and returns to the donor or the donor's spouse.[27] By routing assets through a continuing trust for descendants, rather than returning them to the original transferor, upstream planning avoids this rule, even if the decedent dies within one year of funding. Still, planners prefer that the trust be funded at least one year before the Upstream Person's death to eliminate any uncertainty.

3. Non-Grantor Trusts

In estate planning contexts, practitioners often singularly focus on the benefits of grantor trusts, which is well warranted given the powerful synergistic effects grantor trust status can have with the freeze techniques discussed above. If one of the grantor trust "triggers" in Subpart E of Subchapter J (I.R.C. §§ 671–679) causes the grantor to be treated as the owner of an irrevocable trust used as a value freeze, the grantor, not the trust, pays all income tax attributable to the trust's income, deductions, and credits. Rev. Rul. 2004-64 confirms that the grantor's payment of this tax is not a taxable gift to the trust or its beneficiaries, even though it economically benefits them by allowing trust assets to compound without erosion for income tax. This produces two concurrent advantages: trust assets grow income-tax free from the beneficiaries' perspective, and the grantor's own taxable estate is reduced dollar-for-dollar by the income and capital gains tax paid on trust income, effectively creating an additional transfer to the trust that is outside the gift and estate tax system.

With the increased importance of Section 1202 of the Internal Revenue Code ("Section 1202"), however, the authors believe that non-grantor trusts may deserve a renewed attention, at least in some circumstances. For many clients, particularly those anticipating liquidity events, the most significant tax exposure arises not from transfer taxes but from income and capital gains at realization. In this context, the QSBS exclusion under Section 1202 can be one of the most powerful tools in the modern planner's repertoire. When coupled with non-grantor trust planning, QSBS "stacking" can multiply the available exclusion and produce extraordinary results.

3.a. Section 1202 and the OBBBA Expansion

Section 1202 provides that noncorporate taxpayers may exclude up to 100 percent of the gain recognized upon the sale of QSBS held for more than five years, provided that the stock meets the statutory requirements at issuance and throughout the holding period. For stock acquired after July 4, 2025, the exclusion now applies to the greater of (i) $15 million per taxpayer, per issuer (reduced by prior exclusions for that issuer and indexed for inflation) and (ii) ten times the taxpayer's aggregate adjusted basis in the QSBS sold

[27] I.R.C. § 1014(e).

during the taxable year. This replaces the prior $10 million cap, thereby materially enhancing the value of the incentive for founders and early investors.

To qualify as QSBS, the stock must be (i) issued by a domestic C corporation after August 10, 1993, and acquired by the taxpayer at original issuance and (ii) held for more than three to five years (depending on when the stock was issued). See chart below for the gain exclusion percentages appliable to different issuance dates and holding periods:[28]

Stock Issuance Date	**QSBS Gain Exclusion**
Aug. 11, 1993 – Feb. 18, 2009	50% (for stock held at least 5 years)
Feb. 19, 2009 – Sept. 27, 2010	75% (for stock held at least 5 years)
Sept. 28, 2010 – July 3, 2025	100% (for stock held at least 5 years)
July 4, 2025 – present	50% (for stock held at least 3 years) 75% (for stock held at least 4 years) 100% (for stock held at least 5 years)

Further, the stock must be issued by a corporation (i) whose aggregate gross assets do not exceed $75 million before and immediately after issuance (increased from $50 million under prior law) and (ii) that uses at least 80 percent of its assets in the active conduct of a qualified trade or business. The corporation must avoid holding an excessive amount of investment-type or portfolio assets, and prolonged retention of large working-capital balances that are not reasonably needed for the business can jeopardize the 80 percent active business test.[29] Certain service-based businesses, such as health, law, accounting, financial services, and hospitality, are excluded from the definition of a "qualified trade or business." Gain excluded under Section 1202 is also excluded from the net investment income tax imposed under I.R.C. § 1411, further increasing the benefit.[30]

3.a.i. Rationale and Structuring Considerations

From a planning standpoint, the QSBS regime rewards those who assume early-stage risk in growth-oriented ventures. The structure is particularly attractive for clients forming new operating companies expected to pursue outside investment or a future sale. Because the exclusion applies only to C corporation stock acquired at original issuance,

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[28] I.R.C. § 1202(a).

[29] I.R.C. § 1202(e)(6).

[30] I.R.C. § 1411(c)(1)(A)(iii).

entity selection and capitalization must be addressed at formation.[31] Limited liability companies, S corporations, and later-converted entities generally do not qualify retroactively. Practitioners should confirm that incorporation occurs before the corporation's assets exceed the $75 million threshold, as any excess disqualifies later-issued stock. Moreover, the "original issuance" requirement necessitates that founders receive stock directly from the corporation for money, property, or services rendered, not through secondary transfers. The typical advice for entrepreneurs starting a new venture is that S corporation status should be elected to avoid the corporate level taxation (and limit the self-employment tax to a reasonable salary); however, for more "scalable" businesses, the usual benefits of S corporations should now be weighed against any potential benefits under Section 1202. The equation will likely favor the C corporation status when the shareholders do not plan to take much distributions out of the company and will reinvest most of the profits, because the burden of the shareholder-level tax will then be reduced.

Special care should also be taken to avoid disqualifying redemptions. Section 1202(c)(3) and related provisions effectively "taint" stock where there are significant redemptions by the corporation or certain related parties within a two-year window before or after issuance. Redemptions of the taxpayer's stock or that of persons related to the taxpayer can cause all stock issued in the tainted period to lose QSBS status, so planners must review capitalization tables and redemption history carefully and, where possible, defer repurchases until outside the restricted window.[32]

3.a.ii. The Mechanics of "Stacking"

The statutory gain exclusion limit applies per taxpayer, per issuer.[33] Accordingly, each separate taxpayer holding qualifying stock may claim an independent $15 million (or ten-times-basis) exclusion. By transferring QSBS to multiple donees, such as adult children, non-grantor trusts, or other family members, planners can effectively multiply the exclusion across several taxpayers. For example, a founder holding QSBS worth $45 million could transfer a third of the stock to two irrevocable non-grantor trusts, each structured as a separate taxpayer. Assuming the trusts are complete for gift tax purposes and avoid grantor-trust powers under I.R.C. §§ 673–679, each trust may claim its own $15 million exclusion. When the stock is sold after satisfying the five-year holding period, the aggregate excluded gain could approach $45 million ($15 million for the founder and $15 million for each of two trusts).[34] Note that the transfers to the non-grantor trusts will be taxable gifts and use up all of the gift tax exemptions of both the founder and the founder's spouse (assuming that a gift-splitting election is made). Again,

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[31] I.R.C. §§ 1202(c)(1), 1202(d), 1202(e)(3),

[32] *See* I.R.C. §§ 1202(c)(3); Treas. Reg. § 1.1202-2.

[33] I.R.C. § 1202(b)(1).

[34] *See* I.R.C. §§ 641(a), 673–679, 643(f).

however, the exemption usage may not be a real cost if the founder does not plan to make further transfers that need to be sheltered from the transfer tax system.

This strategy demands meticulous attention to drafting and administration. Transfers must be completed gifts to ensure that each trust is treated as a separate taxpayer, and situs selection should favor jurisdictions that will not subject trust income or gains to state-level tax. Tennessee, for example, currently imposes no state income tax on trust income, making it a favored jurisdiction for QSBS stacking. Each trust must also be substantively independent, sharing the same trustee or beneficiary classes across multiple trusts may invite scrutiny under I.R.C. § 643(f) which provides:

> [Two] or more trusts shall be treated as 1 trust if—
>
> (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and
>
> (2)a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.

If the Internal Revenue Service applies this rule, the trusts are aggregated; only one QSBS exclusion applies, defeating the stacking plan. Careful variation of terms, distribution standards, and trustees is advisable.

3.a.iii. Coordination with Other Income Tax and Estate Planning Objectives

QSBS stacking exemplifies the convergence of income tax and estate planning in the post-OBBBA environment. The gifts of QSBS to non-grantor trusts achieve both completed transfers for estate tax purposes and income tax diversification across multiple taxpayers. For some clients, situsing trusts in favorable jurisdictions can also remove otherwise taxable gains from high-tax states.

Because some states do not conform to Section 1202 or conform only partially, the state income tax treatment of a QSBS sale may differ substantially from the federal result. A number of states, including California, Mississippi, and Alabama, do not recognize the federal QSBS exclusion at all, while others, such as New York, conform partially or only for certain tax years.[35] As a result, even when federal gain is fully excluded under Section 1202, the same gain may remain taxable at the state level

[35] Kenneth J. Schwalbert, Jr. & Megan Vandermeer, *Section 1202 and QSBS: A Survey of States That Don't Conform to the Federal Treatment*, Frost Brown Todd (Aug. 8, 2025), https://frostbrowntodd.com/§-1202-and-qsbs-a-survey-of-states-that-dont-conform-to-the-federal-treatment/. South Carolina fully conforms to federal QSBS and allows for the same capital gains exclusion on QSBS for state income tax purposes.

depending on the residence of the seller or the trust and the location of administration. This makes the coordination of trust situs, administration, and ownership structure with state-law QSBS conformity an essential component of planning for clients in high-tax jurisdictions.

Practitioners should also consider the interplay between Section 1202 and I.R.C. § 1045. Section 1045 of the Internal Revenue Code allows deferral (rather than exclusion) of gain on the sale of QSBS held for more than six months but less than five years if the proceeds are reinvested into replacement QSBS within sixty days. Crucially, the holding period of the original QSBS "tacks" onto the replacement stock, so that time spent holding the original shares counts toward the eventual five-year period required for a Section1202 exclusion when the replacement QSBS is later sold. In this way, I.R.C. § 1045 operates as a bridge provision: if a taxpayer must sell before five years, a compliant rollover can both defer the current gain and preserve the path toward a future Section 1202 exclusion once the combined holding period reaches five years and all other QSBS conditions remain satisfied.

3.a.iv. Practical Takeaways

QSBS stacking is a sophisticated yet increasingly mainstream strategy for high-net-worth clients with growth-oriented businesses. When executed in concert with non-grantor trust planning, it allows multiple family members or trusts to hold discrete blocks of QSBS, each eligible for its own exclusion. Because compliance failures can retroactively destroy QSBS status, practitioners should emphasize early planning, proper entity formation, and meticulous documentation of each transfer. Used thoughtfully, Section 1202 stacking represents a prime example of how income-tax-centric planning can now yield greater tangible savings than traditional estate tax minimization techniques.

3.b. Use of Non-Grantor Trusts for State Income Tax Planning

Non-grantor trusts can also be strategically employed to minimize or eliminate state income tax liability, particularly for individuals residing in high-tax jurisdictions. The most common vehicle for this purpose is the incomplete gift non-grantor trust ("ING" trust), which can be established in states without income taxes such as Tennessee, Delaware, Nevada, or South Dakota. The key to this strategy lies in the dual characterization: the trust is structured as a non-grantor trust for income tax purposes under I.R.C. §§ 671–679, making it a separate taxpaying entity, while the grantor retains sufficient powers to render the transfer an incomplete gift for federal gift and estate tax purposes. In practice, an ING trust typically reserves to the grantor either a lifetime limited power of appointment or a consent or veto power with respect to distributions, often exercisable in conjunction with a committee of adverse parties.

By administering the trust in a no-income-tax state and ensuring non-grantor status, income generated by the trust—particularly portfolio income not sourced to the grantor's home state—escapes state taxation entirely. However, practitioners must weigh this benefit against the compressed federal tax brackets applicable to non-grantor trusts, which reach the highest marginal rate of 37% at only $15,650 of taxable income for 2025.[36] Consequently, this strategy is most advantageous for grantors already in the highest federal bracket who can achieve state tax savings without increasing their overall federal tax burden. Additionally, certain states have enacted legislation specifically targeting ING trusts—New York now treat ING trusts as grantor trusts for state income tax purposes, effectively eliminating the state tax benefit for residents of those jurisdictions.[37]

Further, non-grantor trusts can be used to "stack" multiple state and local tax ("SALT") deductions under the OBBBA, which temporarily increased the SALT cap from $10,000 to $40,000 per taxpayer through 2029.[38] Because each non-grantor trust is treated as a separate taxpaying entity for federal income tax purposes, it is entitled to claim its own SALT deduction up to the applicable cap. By transferring fractional interests in income-producing assets—such as rental properties or investment portfolios—into multiple non-grantor trusts established for different beneficiaries, a high-net-worth taxpayer can multiply the available SALT deductions.

4. Conclusion

The higher estate tax exemption under the OBBBA requires practitioners to reassess traditional planning approaches. Rather than automatically employing strategies to move assets out of an estate, planners should evaluate whether allowing appreciated property to pass at death serves the client's overall tax objectives. The techniques discussed in these materials—including strategic use of powers of appointment, decanting, and upstream basis planning—offer practical methods for capturing basis step-ups while remaining mindful of transfer tax considerations. For clients with business interests, the expanded Section 1202 exclusions and the potential benefits of non-grantor trust planning warrant evaluation, particularly where liquidity events are anticipated. Effective planning in this environment requires attention to both income and transfer tax implications. By integrating basis management and Section 1202 into the broader estate planning framework, practitioners can help clients achieve more tax-efficient wealth transfers across multiple generations.

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[36] Rev. Proc. 2024-40.

[37] N.Y. Tax Law § 612(b)(41).

[38] I.R.C. § 164(b)(7).

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Legislative Updates; Planning Under the Big Beautiful Bill

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2025-2026 State and Federal Legislative Updates

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South Carolina Legislative Updates

- Small Estate Affidavit
- Rule Against Perpetuities
- Grantor Trust Income Tax Reimbursement
- Other clarifying updates

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Federal Legislative Updates

- OBBBA
  - Estate Tax Exemption Amount
  - SALT Cap
  - Charitable Giving

3

Other Updates to Monitor

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2025-2026 State and Federal Legislative Updates

1. State Legislative Updates
    a. Small Estate Affidavit Amount
        i. Increased from $25,000 to $45,000 (after subtracting liens and encumbrances) for decedent's dying on or after May 8, 2025
        ii. Requirements to collect personal property via affidavit:
            1. At least 30 days have passed since decedent's death
            2. Estate does not contain any real property
            3. Value of total probate estate is $45,000 or less after subtracting the value of liens and encumbrances
            4. An application or petition for the appointment of a personal representative has not be filed in any jurisdiction
        iii. Affidavit must also state that the claiming successor is entitled to the property
        iv. Filing requirements:
            1. Will (if any)
            2. Death Certificate
            3. Form 300
                a. Select Probate of Will, if a will exists
                b. Do not select appointment of Personal Representative
            4. Form 420ES
    b. Rule Against Perpetuities
        i. The wait-and-see period for a non-vested interest to either vest or terminate under the South Carolina Rule Against Perpetuities ("SCRAP") was extended from 90 years to 360 years
        ii. The SCRAP is a two-prong test:
            1. A non-vested property interest is invalid unless:
                a. **<u>When the interest is created</u>** it is certain to vest or terminate no later than twenty-one years after the death of an individual then alive; **or**
                b. the interest either vests or terminates within three hundred sixty years after its creation.
            2. The second prong of the test is referred to as the wait-and-see period. An interest can violate the first prong of the test, but if the nonvested interest actually vests or terminates within three hundred sixty years after its created, it is a valid interest.
        iii. Savings Language
            1. Savings clause was also added to the SCRAP to address language that seeks to disallow vesting or termination of an interest based

upon *the later of*: (I) the expiration of a period of time not exceeding twenty-one years after some life or lives in being or (II) the expiration of ninety/three hundred sixty years from the creation of the interest.

2. This type of "later of" clause can violate the rule against perpetuities and is therefore, not an effective savings clause.
3. This change was added to the Uniform Statutory Rule Against Perpetuities in 1990, three years after adoption of the SCRAP. This addition is conforming the SCRAP to the uniform rule.

iv. Judicial Reformation
1. Time period has also been extended to 360 years

v. **These revisions are retroactive**.
1. Section 27-6-60(A) still provides that [the SCRAP] applies to a nonvested property interest or a power of appointment that is created on or after July 1, 1987.

c. Grantor Trust Income Tax Reimbursement

i. Grantor trust income tax reimbursement is a discretionary power given to the trustee of a trust to reimburse the grantor of a trust, as such term is used in Section 671 of the Internal Revenue Code, for any amount of the grantor's income tax liability that is attributable to the inclusion of the trust's income in the grantor's taxable income.

ii. This discretionary power applies to all trusts that are governed by the laws of the state of South Carolina or that have a principal place of administration within this state, whether created on, before, or after January 1, 2025, unless:
1. the terms of the trust expressly prohibit such reimbursement or payment of taxes on grantor's behalf by the trustee,
2. the trustee irrevocably elects out of Section 62-7-508, or
3. applying the provisions of Section 62-7-508 would prevent a contribution to the trust from qualifying for, or would reduce, a federal tax benefit, including the gift tax annual exclusion, the marital deduction, a charitable distribution, or direct skip treatment as it relates to the generation-skipping transfer tax.

iii. If the trustee of the trust wishes to elect out of Section 67-2-508, the trustee must provide written notification to grantor and to all persons who have the ability to remove and replace the trustee ninety days prior to the effective date of such election unless such notice period is waived by the persons to whom notice is required.

iv. The trustee must also be what is considered an independent trustee.

1. A trustee is not an independent trustee, and therefore is prohibited from exercising such reimbursement power, if the trustee is:
    a. the grantor of such trust,
    b. a beneficiary of such trust, or
    c. is a related or subordinate party under Section 672(c) of the Internal Revenue Code, with respect to a person described in a. or b.

v. Section 62-7-505 has been modified to provide that the trustee's discretionary authority to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or trust principal that is payable by the settlor may not be considered to be an amount that can be distributed to or for the settlor's benefit.
    1. Under the general rule of Section 62-7-505, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit.
    2. This revision to Section 62-7-505 specifically provides that trust assets will not be subject to the claims of the grantor's creditors merely because of a trustee's discretionary authority to pay directly or to reimburse grantor for the payment of income tax pursuant to Section 62-7-508.
    3. Important for compliance with Revenue Ruling 2004-64

d. Other notable legislative updates
    i. Section 62-7-504 has been revised to clarify that a beneficiary will not be considered to be a settlor, to have made a voluntary or involuntary transfer of the beneficiary's interest in the trust, or to have the power to make a voluntary or involuntary transfer of the beneficiary's interest in the trust merely by the beneficiary holding or exercising a testamentary power of appointment.
        1. Thus, a creditor does not have access to trust assets merely because a beneficiary has or exercises a testamentary power of appointment.
        2. This addition is consistent with the provisions of Section 62-7-103(14), which provides that trust assets are not subject to the claims of a beneficiary's creditors, nor shall the beneficiary be considered a settlor of the trust, merely because the beneficiary possesses, allows to lapse, releases, or waives a power of withdrawal during the beneficiary's lifetime.
        3. Section 62-7-504(g) simply clarifies that this protection also applies at the beneficiary's death.

ii. Section 62-7-505(b)(3) has been added to provide that any portion of a trust, whether created on, before, or after January 1, 2025, that can be distributed to or for the settlor's benefit solely because the settlor's interest in the trust was created by the settlor's spouse or by any third party, whether through the exercise of a power of appointment or otherwise is considered to have been contributed to the trust by the person exercising the power of appointment or otherwise creating the interest and not by the settlor.

2. Federal Legislative Updates – OBBBA
    a. Estate Tax Exemption Amount
        i. Increased permanently to $15,000,000 per person indexed for inflation
    b. Salt Cap
        i. Temporarily capped at $40,000 per household
        ii. Potential planning opportunity with stacking non-grantor trusts
    c. Charitable Giving
        i. 60% AGI limit for cash contributions is now permanent
        ii. New .5% AGI floor
        iii. New senior deductions
            1. 65 or older
            2. Allows deduction up to $6,000 per person or $12,000 per couple on top of regular standard deduction
            3. Phased out for higher-income earners
        iv. Nonitemized filers can deduct up to $1,000 (for single filers) or $2,000 (for married filing jointly) in cash gifts to charities from their taxable income each year
3. Other potential legislation to monitor

South Carolina Bar

Continuing Legal Education Division

Probate and Estate Planning-Select Topics

Aaron Nelson

Tax Consequences of Trust Transactions

Presented by

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Owner, The Nelson Law Firm of Bluffton, LLC

1

Introduction

This material is intended only to show that there are federal tax consequences, and not just state trust code statutes, that must be considered when a trust enters into a transaction.

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What Types of Matters Cause Issues

- Judicial modifications
- Decanting
- Trust Protectors

3

Key Tax Areas Implicated

- Gift Tax (Ch. 12)
- Estate Tax (Ch. 11)
- Generation-Skipping Transfer ("GST") Tax (Ch. 13)
- Income Tax Considerations

4

Adding and Releasing General Powers of Appointment

- A General Power of Appointment ("GPOA") is the ability to vest trust property in the power holder, the powerholder's estate, the power holder's creditors, or the creditors of the powerholder's estate.
- Releasing a GPOA is considered a gift.
- The concept is straightforward and statutory.

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Concept of Releasing a General Power of Appointment

- If the beneficiary has the ability to take something, but do not, that has the same effect as taking it and putting it back.
- In the non-tax world:
  - Aaron: Would you like the last piece of pie?
  - Bo: No thanks, you take it.
  - Aaron: My brother gave me the last piece of pie.
- This is important because CCA 202352018 rests on the same rationale.

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Withdrawal Rights

- Because only gifts of present interests qualify for the gift tax annual exclusion, withdrawal rights are often used when making gifts to trusts.
- A withdrawal right is a GPOA because the powerholder has the ability to vest the trust property in himself.

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Five and Five Rule

- If a GPOA lapses, it will only be considered a release of that power to the extent it exceeds the greater of $5,000 or 5% of the trust property from which the GPOA could have been satisfied.
- Trusts are often drafted so that the withdrawal rights do not exceed this, or if they do, the full withdrawal right does not lapse or the lapse is an incomplete gift

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Adding a General Power of Appointment

Why?

- After the death of the powerholder-beneficiary, the assets receive a step-up in basis.
- This works because the large estate tax exemption makes it such that the powerholder-beneficiary doesn't care if the trust's assets are included in his or her estate.

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Adding a General Power of Appointment

How?

- Trust Protector empowered to grant a general power of appointment
- Judicial Modification
- Decanting
- Delaware Tax Trap

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Delaware Tax Trap – I.R.C. 2041(a)(3)

- This section provides that the gross estate includes property if a powerholder exercises a power of appointment to create a power of appointment (the "Second Power") and the exercise of the Second Power is not subject to the same Rule Against Perpetuities as the first power.
- Because of the Rule Against Perpetuities, within a given timeframe, the IRS expects for assets to be included in someone's taxable estate and creating powers of appointment with powers of appointment is a way around that.

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Adding a General Power of Appointment

Side Effects

- Do beneficiaries who do not object to the modification make a gift?
  - Less concerning if added by a trust protector or decanting.
  - Consent to a judicial modification is worse.
- Including too much in the taxable estate of the powerholder?
  - Reduction of exemption
  - Appreciation of assets
  - Prior (unknown) taxable gifts
  - Formula GPOA?

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Dispositions of Qualifying Income Interest – I.R.C. 2519

- I.R.C. 2519 provides that any disposition of a portion of a qualifying income interest is a transfer of all interests in such property other than the qualifying income interest if a marital deduction was allowed for such property.

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Dispositions of Qualifying Income Interest – I.R.C. 2519

- Rationale: The IRS wants its bite at the apple and because the IRS did not get to tax the assets at the first death (because of the unlimited marital deduction), they need to tax it at either the second death (I.R.C. 2044) or during the surviving spouse's lifetime if the interest is disposed of (I.R.C. 2519).

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Common Transactions Triggering I.R.C. 2519

- Termination of a QTIP Trust
- Sale or release of life interest

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Terminating a QTIP Trust

- Under South Carolina law (Section 62-7-411), the beneficiary of a trust can agree to terminate the trust.
- In such a case, the assets are typically distributed in accordance with the actuarial interests of the beneficiaries with the remainder beneficiaries receiving a portion of those assets.
- Those assets that pass to the remainder beneficiaries are no longer included in the surviving spouse's taxable estate.

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I.R.C. 2519 Example

- Suppose Husband creates a QTIP Trust for Wife at his death which is now worth $500,000.
- Pursuant to a judicial termination, the trust is terminated and Wife receives $100,000 as her interest in the trust (determined on an actuarial basis).
- The remainder beneficiaries receive the remaining $400,000.

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I.R.C. 2519 Example - Continued

- It is treated as a gift of all trust property by the surviving spouse other than the value of her qualifying income interest.
- Gift of all trust property ($500,000) less the value of her interest ($100,000). The taxable gift is $400,000.
- If it were terminated and all proceeds distributed to the remainder beneficiaries, the gift of her qualifying income interest (the $100,000) is treated as a gift from her under I.R.C. 2511.

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I.R.C. 2519 Hypothetical

- What if the trust were modified to remove a power of appointment held by the surviving spouse?
- CCA 202352018 says that the consent (or failure to object) by the surviving spouse is a gift.
- Has the surviving spouse "disposed" of a portion of the trust for which the marital deduction was taken?

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I.R.C. 2519 Hypothetical Continued

- Conceptually, this should not be subject to I.R.C. 2519 because the value of the trust is still included in the surviving spouse's estate under I.R.C. 2044.
- How do we get there? Easiest way is that the value of the surviving spouse's qualifying income interest is still the value of the entire trust.

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Chief Counsel Advice 202352018

- A grantor trust was created in which the trustee did not have the discretionary authority to reimburse the trust's grantor for income tax payments related to the trust.
- The Trustee petitions the state court to modify the terms of the trust to allow those discretionary reimbursement provisions.
- All of the beneficiaries consent to the modification

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What is a Chief Counsel Advice?

- Non-precedential.
- Internal guidance issued by the Office of Chief Counsel to IRS employees.

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IRS's Position

- The beneficiaries who consented to the modification have made a gift to the trust's grantor by giving the grantor a right he or she did not have before.
- Problems with valuing the gift are what makes this so concerning.

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Failing to Object

- The CCA states that the result would be the same if the beneficiary had not consented, but instead had the right to object and did not.
- Failing to exercise a right (like allowing a withdrawal power to lapse), can be a gift.
- How far must one take an objection?

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Valuing the Gift

- I.R.C. 2702 says that if the transfer is in trust for the benefit of the transferor's family, the value of the retained interest is zero.
- Language from the CCA: "[the Grantor] acquires a beneficial interest in the trust property in that [the Grantor] becomes entitled to discretionary distributions . . . ."

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Incomplete gift?

- Could it be an incomplete gift until a reimbursement was actually made (and we knew how much)?
- Do we want it to be?

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Modification/Decanting of Exempt Trusts

- The regulations only address grandfathered trusts but it is likely that trusts which are exempt because of having GST tax exemption allocated to them will be analyzed under the same tests.
- Discretionary Distribution Safeharbor (decantings)
- Trust Modification Safeharbor
- Aimed at ensuring the property vests (i.e., included in someone's taxable estate) on assumed timetables.

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Discretionary Distribution Safeharbor

- When the original trust became irrevocable, the trust or local law allowed the distributions to the new trust.
- Neither beneficiary consent nor court approval is required.
- Second trust will not suspend the vesting beyond the federal perpetuities period, which is the later of:
  - A life in being plus 21 years; or
  - Ninety years

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Trust Modification Safeharbor

- The modification does not shift a beneficial interest to a beneficiary of a lower generation; and
- The modification does not extend the time for vesting of any beneficial interest beyond the period provided in the original trust.

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Income Tax Consequences

- Income to the trust
- Income to the beneficiaries

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Income to the Trust

- For decantings, there should be no income to the trust because either:
  - The original trust and the second trust should be treated as the same for income tax purposes; or
  - The decanting carries out the DNI of the first trust.
- At least for "complete" decantings, most commentators agree with option #1 and go so far as to say that the second trust should use the same EIN as the first trust.

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Income to the Beneficiaries

- Generally, no income to the beneficiaries, but with two exceptions:
  - Transferring negative basis assets.
  - Changing grantor trust status.

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Transferring Negative Basis Assets

- When a transferee assumes the transferor's liability, the amount realized includes the amount of the liability assumed. *Crane v. Comm'r.*, 331 U.S. 1 (1947).
- I.R.C. 752(d) provides that the transfer of a partnership interest with debt in excess of basis will result in gain.
- But, I.R.C. 643(e) provides that a beneficiary receives a carryover basis in property received in a distribution from the trust.

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Grantor Trust Conversions

- Grantor → Grantor = No Gain.
- Non-Grantor → Grantor = No Gain (probably).
- Grantor → Non-Grantor = Gain if negative basis asset is "transferred."

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Tax Consequences of Trust Transactions

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Tax Consequences of Trust Transactions

I. Introduction

1. The purpose of this material is to provide an overview of federal tax consequences triggered by common trust transactions. There are a lot more matters that come up in practice, this material is intended only to show that there are federal tax consequences, and not just state trust code statutes, that must be considered when a trust enters into a transaction.

2. State-law methods which create some of these problems:

    a. Judicial modifications
        i. To a lesser extent non-judicial settlement agreements ("NJSA") because of the limitations in our NJSA statute.
        ii. Other states' NJSA statutes are much broader and could cause problems if used to make the changes discussed below.
    b. Decanting
    c. Trust Protectors

3. Key tax areas implicated:

    a. Gift Tax (Ch. 12)
    b. Estate Tax (Ch. 11)
    c. Generation-Skipping Transfer ("GST") Tax (Ch. 13)
    d. Income Tax Considerations

4. The prevalence of CCA 202352018 (the "CCA")

Adding and Releasing General Powers of Appointment

1. Releasing a general power of appointment is a gift equal to the value of the assets over which the powerholder could have exercised such power. I.R.C. § 2514(b).

    a. Straightforward, statutory, and conceptually sound.
    b. Withdrawal rights are general powers of appointment because the powerholder (beneficiary) has the right to vest that property in themselves.
        i. Voluntarily allowing a withdrawal power to lapse is a release of that general power and therefore a gift by the powerholder. I.R.C. § 2514(e).

1. This is an important concept because it is the codification of a concept used in the CCA.
2. A beneficiary does not have to take any affirmative action to be deemed to have made a gift. A failure to exercise a right can be a gift.

ii. Five and Five Rule
1. I.R.C. § 2514(e) further provides that if a general power of appointment (usually a withdrawal right) lapses, if will only be considered a release of that general power *to the extent* value of the property over which they held such power exceeds the greater of $5,000 or 5% of the total value of assets over which the power could have been satisfied.
2. If the lapsed power exceeds the threshold, then there is a release, but reduced by the threshold (i.e., it is not all-or-none).

iii. Incomplete gift
1. Treas. Reg. § 25.2511-2(b) provides that if a donor (the release/lapse is a transfer under I.R.C. § 2514(b) and so they are the donor/transferor) retains the right to control the ultimate disposition of the assets, the gift may be incomplete.
2. Oftentimes with so-called *Crummey* withdrawal rights, the beneficiary retains the right to control the ultimate disposition of the assets via a limited power of appointment at their deaths. As such, the lapse of these powers will not be considered completed gifts.

2. It has recently become common where a general power of appointment is added to trusts (usually bypass trusts) in order to include the trust's assets in the power-holder's estate in order to get a step-up in basis at the surviving spouse's death.

a. The reason this has become so common is that the very large estate tax exemption make it such that even if the bypass trust is included in the taxable estate of the surviving spouse, there will be no tax at the surviving spouse's death.
b. Options for accomplishing this:
i. "Trust Protectors" (even if not called that) are sometimes given the powers in the documents
ii. Judicial trust modifications
iii. Decanting
iv. Intentionally triggering the Delaware Tax Trap under I.R.C. § 2041(a)(3).

c. The most common power added is the power to appoint to the creditor's of the surviving spouse's estate.

3. I.R.C. § 1014 gives those inheriting the property a basis equal to such property's fair market value as of the beneficiary's date of death. Because of the large estate tax exemption, there should be no tax at the beneficiary's death.

4. Side-Effects

   a. Depending on the method by which the general power of appointment is given to the beneficiary, there could be a gift by the remainder beneficiaries.
      i. If the Trust Protector added the power or if a decanting added the power, the beneficiary did not consent and therefore there is no gift. However, the CCA states that it is the IRS's position that this is still a gift by the remainder beneficiaries because of their failure to contest the action.
      ii. This becomes even more troublesome if it is a judicial modification (often under S.C. Code § 62-7-411) because the remainder beneficiaries have consented.
   b. One thing to keep an eye on when adding such a power is that it has the potential to cause estate tax at the powerholder's death. This could occur because of:
      i. Reduction in the exemption.
      ii. Appreciation of assets.
      iii. Prior (unknown) taxable gifts.

II. I.R.C. § 2519 Transactions – Dispositions of Qualifying Income Interests

1. Overview of § 2519

   a. Section 2519 provides that any disposition of a portion of a qualifying income interest is a transfer of all interests in such property other than the qualifying income interest if a marital deduction was allowed for such property.
   b. Rationale is that the value of the entire property was going to be included in the spouse's estate and if for some reason that property is no longer included (typically because the trust is terminated and no longer in existence), then the spouse must have made a transfer (because the only way to move assets out of your taxable estate are to transfer them) of the assets that are no longer includible in her taxable estate.

c. The IRS wants its bite at the apple, and it didn't get a chance at the first death because of the marital deduction.
d. It is seen as the gift tax counterpart to I.R.C. § 2044.
e. This is most usually seen with the termination of a QTIP trust where a portion of the trust is distributed to the non-spouse remainder beneficiaries in accordance with their actuarial values, but it is not limited to only the QTIP trust scenario. It applies to all qualifying income interests (i.e., life estates).

2. **Common Transactions That Trigger § 2519**

a. Termination of a QTIP Trust
    i. Under South Carolina law, the beneficiaries of a QTIP trust could agree, pursuant to S.C. Code § 62-7-411 to terminate such trust.
    ii. In such a case, the assets of that trust are typically distributed according to actuarial values with a portion (sometimes significant portion) being distributed to the remainder beneficiaries.
b. Sale or release of life interest.
    i. It is important to note that I.R.C. § 2519 applies even in the context of a sale of the qualifying income interest.
    ii. Most of the time such a transaction is prohibited by a spendthrift clause.
c. What if a QTIP trust was modified to remove a power of appointment (even limited) the spouse held or the spouse released that right?
    i. Is it a "disposition?" of "all or any part" of the spouse's qualifying income interest?
    ii. The CCA says that she's made a gift because she gave up a right she has in the property, but is that a "disposition?"
    iii. It is still included in her estate under I.R.C. § 2044.
    iv. What is the value of her retained income interest?

3. An Example of the Tax Consequences

a. Husband establishes a QTIP trust for wife that pays to his children upon the wife's death. It is now valued at $500,000.
b. Pursuant to judicial termination, the value of the wife's qualifying income interest (assume it is valued at $100,000 based on her age) is distributed to her. The balance ($400,000) is distributed to husband's children.

c. Wife has made a gift of $400,000 to husband's children – the value of all trust property ($500,000) less the value of her qualifying income interest ($100,000).
d. If Wife consents to giving the children all of the trust, the gift tax consequences of transferring her qualifying income interest are determined under I.R.C. § 2511 (a "regular" transfer).

III. Chief Counsel Advice 202352018

1. Oversimplification of the facts:

    a. A grantor trust was created in which the trustee did *not* have the discretionary authority to reimburse the trust's grantor for income tax payments related to the trust.
    b. The Trustee petitions the state court to modify the terms of the trust to allow those discretionary reimbursement provisions.
    c. All of the beneficiaries consent to the modification.

2. It is the IRS's position (and it's important to note that it is just that – the IRS's position), that the beneficiaries have made a gift because they have relinquished a portion of their interest in the trust.

3. Conceptually, it is a rational decision, nevertheless it causes a lot of heartburn because of the valuation issue discussed below.

4. The CCA provides that the result would be the same if a beneficiary had a right to object and did not.

    a. What if they had a right to object but no grounds (i.e., they knew they would lose)?
    b. How far must they object? Take it to trial?
    c. The grandfathered GST regulations actually have an exception for reasonable settlements. Treas. Reg. § 26.2601-1(b)(4)(i)(B).

5. Valuing the gift

    a. If the income tax payments were so high that it started to sting the Grantor, the anticipated tax reimbursements must have been substantial.
    b. I.R.C. § 2702 says if it is a transfer of an interest in trust for the benefit of a member of the transferor's family, then the value of the retained interest is zero unless the transferor can prove otherwise.

i. The CCA actually states that "[the Grantor] acquires a beneficial interest in the trust property in that [the Grantor] becomes entitled to discretionary distributions . . . ."
ii. Grantor is a member of the transferor's family.

c. Is it an incomplete gift until a reimbursement distribution is actually made?
   i. A gift is made at one point in time and the valuation is made at that point.
   ii. Could it have been made an incomplete gift by requiring consent of the beneficiaries at the time of exercise?
      1. If we get around the I.R.C. § 2702 issue, would we prefer to have a gift with a lot of contingencies but hard to value or have a gift that is easy to value, but with no contingencies.
      2. Because the tax reimbursements were likely to be large, trying to make the gift incomplete until actually paid, would probably have been worse.

IV. Modification or Decanting of Grandfathered or Exempt GST Trusts

1. While the regulations only address the decanting of grandfathered trusts, the Service has indicated they will apply the same rationale to trusts which are exempt from the GST tax because of the allocation of GST tax exemption. PLR 200743028.

2. There are two potential safeharbors that may be applicable. Those are in Treas. Reg. § 26.2601-1(b)(4)(i)(A) and 26.2601-1(b)(4)(i)(D). Those are the discretionary distribution safeharbor and the trust modification safeharbor.

3. Discretionary Distribution Safeharbor –Treas. Reg. § 26.2601-1(b)(4)(i)(A).

   a. When the original trust became irrevocable, either the terms of the original trust instrument or local law authorized the trustee to make distributions to a new trust;
   b. Neither beneficiary consent nor court approval is required; and
   c. The second trust will not suspend or delay the vesting of an interest in trust beyond the federal perpetuities period, which is measured from the date the original trust became irrevocable to the later of:
      i. A life in being plus twenty-one years; or
      ii. Ninety years.

4. Trust Modification Safeharbor – Treas. Reg. § 26.2601-1(b)(4)(i)(D).
    a. The modification does not shift a beneficial interest to a beneficiary of a lower generation than the person holding the interest under the original trust; and
    b. The modification does not extend the time for vesting of any beneficial interest beyond the period provided in the original trust.

V. Income Tax Consequences

1. Income to the Trust (for Decanting)

    a. Decanting assets from one trust to another should not result in income to original trust or the second trust because either:
        i. The original trust and second trust are treated as the same trust for income tax purposes (*See* PLR 200736002); or
        ii. Because the transfer from the original trust to the second trust carried out the original trust's distributable net income ("DNI") to the second trust. The second trust would receive taxable income to the extent of the original trust's DNI, but the original trust would be entitled to a corresponding deduction under I.R.C. § 661(a) to the extent of the original trust's DNI; therefore, there would be no income to the trusts in the aggregate.

    b. Alternative #1 above is the favored alternative (*see* PLR 200607015) and most commentators agree that the second trust should continue to use the same Employer Identification Number as the original trust.

2. Income to the Beneficiaries.

    a. Beneficiaries should not have any income tax consequences upon the modification or decanting unless grantor trust status is changed or there is a transfer of negative basis assets.

        i. In PLR 200743022, the Service clarified that decanting will not result in income to a trust's beneficiaries so long as the decanting is authorized by the trust instrument or state law.

        ii. The rationale being that the beneficiaries' interests were always subject to the trustee's ability to decant so there has been no change in the quality of the beneficiaries' interests.

b. Caveat – negative basis assets (debt in excess of basis or a partnership interest with a negative capital account).

    i. *Crane v. Comm'r*, 331 U.S. 1 (1947) held that when a transferee assumes a transferor's liability, the amount realized under I.R.C. § 1001 includes the amount of the liability assumed by the transferee. From this it appears that income will result to the beneficiaries.

    ii. I.R.C § 752(d) provides that the transfer of a partnership interest with debt in excess of basis will result in a gain to the extent of the negative capital account.

    iii. However, I.R.C. § 643(e) provides that a beneficiary will receive a carryover basis in property received in a distribution from a trust. Therefore, the question becomes whether I.R.C. § 643(e) overrides the principles of *Crane* and I.R.C. § 752(d). The answer to this is unclear.

c. Grantor Trust Conversions

    i. Gain will not be recognized if the decanting is between two grantor trusts because transactions between grantor trusts are disregarded for income tax purposes.

    ii. Mere conversion of a non-grantor trust to a grantor trust is not a transfer for income tax purposes. CCA 200923024.

    iii. Gain will be recognized by the grantor if the decanting is between a grantor trust (the original trust) and a non-grantor trust (the second trust) if a negative basis asset is transferred. I.R.C. § 643(e) does not control in this context because it does not apply to grantor trusts. *See* Treas. Reg. § 1.1001-2(c), Example 5.