United States Senate

WASHINGTON, DC 20510

March 20, 2023

The Honorable Janet Yellen
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Yellen:

We write in support of your strong commitment to tax fairness and to urge you to use your existing authority to limit the ultra-wealthy's abuse of trusts to avoid paying taxes. Billionaires and multi-millionaires use trusts to shift wealth to their heirs tax-free, dodging federal estate and gift taxes. And they are doing this in the open: their wealth managers are bragging about how their tax dodging tricks will be more effective in the current economy. While we look forward to continuing to partner with you on legislative solutions, the Treasury Department can and should exercise the full extent of its regulatory authority to limit this blatant abuse of our tax system by the ultra-wealthy.

Most Americans work for any money that they are able to save, with many struggling to save at all. The vast majority of Americans never receive an inheritance[1] and of those who do, the vast majority do not owe any taxes.[2] Only the wealthiest American families – those with over $25.84 million in wealth for a married couple – are asked to chip in a share via transfer taxes, and only on each dollar over that whopping $25.84 million exemption.[3] These transfer taxes include the estate tax, gift tax, and generation-skipping transfer (GST) tax and provide a small check on the growing wealth gap. They also generate revenue that we can invest in public infrastructure like roads and schools that all Americans, wealthy or not, need to succeed.

Today, less than 0.1% of Americans pay the estate tax.[4] This is partly because of the absurd increases to transfer tax exemptions in the 2017 Republican tax law, which doubled the gift and

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[1] Business Insider, "The typical American heir is now a middle-class 50-something who puts the money towards retirement," Tanza Loudenback, November 21, 2019, https://www.businessinsider.com/personal-finance/older-americans-get-more-inheritances-use-for-retirement-2019-11; Penn Wharton Budget Model, "Inheritances by Age and Income Group," Victoria Osorio and Jon Huntley, July 16, 2021, https://budgetmodel.wharton.upenn.edu/issues/2021/7/16/inheritances-by-age-and-income-group.

[2] Center on Budget and Policy Priorities, "Policy Basics: The Federal Estate Tax," November 7, 2018, https://www.cbpp.org/research/federal-tax/the-federal-estate-tax; CNBC, "Here's how many people pay the estate tax," Greg Iacurci, September 19, 2021, https://www.cnbc.com/2021/09/29/heres-how-many-people-pay-the-estate-tax-.html.

[3] Internal Revenue Service, "Estate Tax," https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax.

[4] Internal Revenue Service, "SOI Tax Stats – Historical Table 17," March 7, 2022, https://www.irs.gov/statistics/soi-tax-stats-historical-table-17; CNBC, "Here's how many people pay the estate tax," Greg Iacurci, September 19, 2021, https://www.cnbc.com/2021/09/29/heres-how-many-people-pay-the-estate-tax-.html.

estate tax exemption for married couples from $11.1 million in 2017 to $22.8 million in 2019 in a massive giveaway to the ultra-wealthy.[5] But there is another cause of this low payment rate: millionaires and billionaires engaging in increasingly complex tax planning that exploits trusts to avoid paying taxes.

Tax avoidance through grantor trusts starts with the ultra-wealthy putting assets into a trust with the intention of transferring them to heirs. Grantor trusts are trusts where the grantor retains control over the assets, and the structures of some of these grantor trusts allow the transfer of massive sums tax-free. Tax planning via grantor trusts, including grantor retained annuity trusts ("GRATs"), is a kind of shell game, with a wealthy person and their wealth managers able to pass assets back and forth in ways that effectively pass wealth to heirs while minimizing tax liability.

Some of the wealthiest families further compound this tax avoidance with perpetual dynasty trusts, which can be used to shield assets from transfer tax liability indefinitely. For example, aggressive valuation discounts can artificially reduce the value of assets transferred into a trust below the GST tax exemption threshold, after which the assets can grow in perpetuity within a trust exempt from transfer tax. Wealth management firms openly brag about the millions in tax dodging they can achieve for their ultra-wealthy clients using a dynasty trust. [6]For example, one wealth management firm advertises the "extraordinary opportunity" to accumulate an additional $367 million of wealth over 75 years by avoiding taxes via dynasty trusts:

> A client's ability to contribute assets to a trust that will continue for generation after generation without the imposition of any transfer tax, and potentially no state income tax, is an extraordinary opportunity when compared to the alternative of passing assets outright, from generation to generation, subject to a federal transfer tax at each generation. Based on a $12.06 million contribution to a trust, a 5 percent after-tax rate of return on the investment assets, a new generation every 25 years, and a federal estate tax of 40 percent applied at each generational transfer, the GST-exempt trust would have an approximate value of $468 million after only 75 years. The same sum of $12.06 million held outside of a trust (and subject to a gift tax or estate tax upon transmittal to each successive generation) would have an approximate value of $101 million.

Although the details of various trusts may differ, the result of wealthy individuals transferring millions in assets to heirs tax-free does not.[7] The ultra-wealthy at the top of the socioeconomic ladder live by different rules than the rest of America, especially when it comes to our tax system. For the overwhelming majority of Americans, the recent market downturn has presented undue hardships, but as one wealth management group says in a "client alert," for the ultra-wealthy "the recent decrease in the market poses an opportunity to transfer wealth with minimal

[5] Tax Policy Center, "Fixing the TCJA: Restoring the Estate Tax's Exemption Levels," Robert McClelland, March 20, 2019, https://www.taxpolicycenter.org/taxvox/fixing-tcja-restoring-estate-taxs-exemption-levels.
[6] The Northern Trust Institute, "Nevada Trusts: Safeguarding Personal Wealth," https://www.northerntrust.com/united-states/institute/articles/nevada-trusts-safeguarding-personal-wealth.
[7] Bloomberg, "Accidental Tax Break Saves Wealthiest Americans $100 Billion," Zachary R. Mider, December 17, 2013, https://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion.

gift tax cost by creating a GRAT. Any security or other asset that has been significantly affected by the decrease may be a strategic asset to fund a GRAT because if the value rebounds, most of the appreciation over the current depressed value will benefit your children with little gift tax consequences."[8] This has been a tried-and-true strategy for the ultra-wealthy. As another wealth management group notes, "taxpayers who utilized this strategy during the 2008 financial crisis were able to make significant tax-free gifts to beneficiaries."[9] As the richest Americans celebrate and take advantage of these favorable tax opportunities, middle class families struggle with inflation and Republicans threaten austerity measures and the end of Social Security and Medicare.[10]

The ultra-wealthy should pay their fair share, not avoid taxes by hiring elite lawyers and accountants. To counter this, the Treasury Department has authority to and should take several actions to address the abuse of GRATs and other grantor trusts,[11] including:

- **Revoke Revenue Ruling 85-13 and follow *Rothstein v. US*[12]:** Revenue Ruling 85-13 provides that the transfer of assets between a grantor and a grantor trust is a non-taxable event for federal income tax purposes. *Rothstein* holds that transfers between a grantor and grantor trusts are taxable events. Revoking Revenue Ruling 85-13 and following *Rothstein*, with appropriate exceptions to prevent disruption of business operations conducted for legitimate non-tax reasons, provides a more sensible tax framework for grantor trusts.

- **Revoke Revenue Ruling 2004-64:** Revenue Ruling 2004-64 holds that gift tax would not apply to a grantor's payment of income tax attributable to trust income, which effectively allows grantors to make additional, tax-free gifts to the trust beneficiaries. By contrast, a 1994 private letter ruling (PLR 9444033) held that a grantor's payment of income tax attributable to trust income would incur gift tax, which is the result that would presumably follow if Revenue Ruling 2004-64 were revoked. The IRS should revoke Revenue Ruling 2004-64 and confirm that when a grantor pays income taxes that are attributable to trust income, those payments are subject to the gift tax. This change would eliminate an unwarranted tax avoidance opportunity for wealthy grantors.

- **Require GRATs to have a minimum remainder value:** The Biden Administration's fiscal year 2023 budget proposal would require GRATs to have a remainder interest

[8] Proskauer, "Funding 'GRATs' in a Market Decline," March 2, 2020, https://www.proskauer.com/alert/funding-grats-in-a-market-decline.
[9] Holland & Knight, "Utilizing GRATs after a Market Downturn," Mark E. Haranzo, March 23, 2020, https://www.hklaw.com/en/insights/publications/2020/03/utilizing-grats-after-a-market-downturn.
[10] Office of Nancy Pelosi, "Sen. Johnson Again Blurts Out Extreme MAGA Contempt for Social Security," August 19, 2022, https://www.speaker.gov/newsroom/81922.
[11] *See* Americans for Tax Fairness, "Recommendations of Items to be Included on the 2022-2023 Priority Guidance Plan," June 7, 2022, https://americansfortaxfairness.org/issue/atf-recommendations-treasury-irs-priority-guidance-plan/; New York University Tax Law Center, "TLC 2022-2023 Priority Guidance Plan," June 2, 2022, https://www.regulations.gov/comment/IRS-2022-0007-0047.
[12] Rothstein v. United States, 735 F.2d 704 (2nd Circuit 1984).

value equal to or greater than 25% of the contributed assets.[13] In the absence of legislative action, however, Treasury should exercise its regulatory authority to require a GRAT's remainder interest to be a set minimum percentage of contributed assets. To qualify for GRAT treatment, the statute requires an annuity interest to consist of "fixed amounts payable not less frequently than annually."[14] But a GRAT with little or no remainder interest risks failing to pay those fixed amounts if its assets fall in value. Treasury should use its regulatory authority to interpret "fixed amounts" to require a minimum remainder interest that would better ensure that the grantor will receive the fixed annuity payments, such as by requiring GRATs to have a remainder interest value of at least 25% of contributed assets.[15] This action would make GRATs far less appealing as a tax avoidance tool.

- **Reissue family limited partnership regulations:** The Obama Administration proposed a regulation, later withdrawn by the Trump Administration, to address the abuse of valuation discounts through family limited partnerships that are used to reduce the value of taxable estates and thereby avoid transfer taxes.[16] Treasury and the IRS should reissue these important regulations to end this abuse of family limited partnerships.

- **Clarify that Intentionally Defective Grantor Trusts (IDGTs) are not entitled to stepped-up basis:** The Treasury Department should use its regulatory authority to issue a regulation or revenue ruling confirming the consensus view that IDGT assets that are not part of an estate for estate tax purposes do not receive stepped-up basis when the grantor dies. The IRS has already taken this logical position in informal guidance (Chief Counsel Advice 200937028), but some aggressive practitioners continue to advise clients that trustees or beneficiaries can claim stepped-up basis for assets in an IDGT when the grantor dies, thus eliminating capital gains tax liability. Treasury should stop this aggressive tax avoidance technique by clarifying that assets in an IDGT do not receive stepped-up basis when the grantor dies.

- **Issue clarifying regulations:** The Treasury Department should issue regulations clarifying language within Section 2702(a) and 26 CFR § 25.2702-3, which address certain valuation rules for estate and gift tax purposes, in order to help to eliminate some exploitative tax opportunities. Specifically, it should clarify:

    - That a "qualified interest" within the meaning of Section 2702(a) has a required minimum and maximum annuity term, which would eliminate the inappropriate planning opportunities created by very short-term or very long-term GRATs.

[13] Department of Treasury, "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals," March 2022, https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf.
[14] I.R.C. § 2702(b)(1); see Treas. Reg. § 25.2702-3(b).
[15] Americans for Tax Fairness, "Recommendations of Items to be Included on the 2022-2023 Priority Guidance Plan," June 7, 2022, https://americansfortaxfairness.org/issue/atf-recommendations-treasury-irs-priority-guidance-plan/.
[16] Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, REG-163113-02, 81 Fed. Reg. 51,413, August 4, 2016.

- That the prohibition on "additional contributions" in 26 CFR § 25.2702-3 regarding trusts with a "qualified interest" applies to asset sales and substitutions, which would remove one opportunity that estate planners exploit to insulate GRATs from downside risk.
- That when a remainder interest is not a "qualified remainder interest," as defined by 26 CFR § 25.2702-3(f), Section 2702 does not apply for determining value. This would ensure that any transfer of a remainder interest would be valued as an ordinary remainder interest, without excluding the grantor's retained interest, thus preventing an inappropriate reduction in the value of a transferred remainder interest.

We share the Biden Administration's desire to stop tax abuse through use of grantor trusts,[17] and, while we look forward to continuing to partner with you on legislative solutions, we strongly encourage the Treasury Department to use its existing authority to limit this tax dodging by the ultra-wealthy. To ensure attention to this matter, we respectfully request the Treasury Department provide answers to the following questions no later than April 3, 2023.

1. Has the Treasury Department considered any administrative action to address tax avoidance through the use of grantor trusts?

2. How much money does Treasury estimate is held in grantor trusts?

3. Some have suggested that tax revenue lost to tax abuse through grantor trusts could be $5-$7 billion annually in the near-term.[18] Please provide an estimate for how much tax revenue the Treasury Department believes could be raised in the near-term and long-term by addressing grantor trust abuse through the Treasury Department's existing authority as outlined in this letter.

    a. How much additional tax revenue would be raised from estates valued at $12.92 million – $50 million?

    b. How much additional tax revenue would be raised from estates valued at $50 million – $100 million?

    c. How much additional tax revenue would be raised from estates valued at $100 million – $1 billion?

    d. How much additional tax revenue would be raised from estates valued over $1 billion?

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[17] Department of Treasury, "General Explanations of the Administration's Fiscal year 2023 Revenue Proposals," pp. 40 – 42, March 2022, https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf.

[18] Bloomberg, "Accidental Tax Break Saves Wealthiest Americans $100 Billion," Zachary R. Mider, December 17, 2013, https://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion; Americans for Tax Fairness, "Recommendations of Items to be Included on the 2022-2023 Priority Guidance Plan," June 7, 2022, https://americansfortaxfairness.org/issue/atf-recommendations-treasury-irs-priority-guidance-plan/.

Thank you for your attention to this matter.

Sincerely,

Elizabeth Warren
United States Senator

Chris Van Hollen
United States Senator

Bernard Sanders
United States Senator

Sheldon Whitehouse
United States Senator