



COMMITTEE REPORT: ESTATE PLANNING & TAXATION

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Get a “GRIP” in This Uncertain Tax Environment

A valuable estate-planning technique for clients who want to lock in what's remaining of their \$11.7 million exemption

With the current environment in Washington, clients are nervous and seeking our advice and guidance more than ever on what they can do to plan for the uncertain looming changes to the Tax Code. Whether under President Biden's American Families Plan, the “99.5% Act,” the Sensible Taxation and Equity Promotion (STEP) Act or the sunset of the tax cuts under the Tax Cuts and Jobs Act, changes to the Tax Code are almost certain. However, what those changes will ultimately be is anyone's guess. This makes it challenging to offer tax planning advice, particularly to those clients who wish to take advantage of the current \$11.7 million gift tax exemption but can't afford to irrevocably give away assets or simply don't want to. For those clients, you may consider the grantor retained interest partnership (GRIP)—a planning technique that allows clients to lock in today's gift tax exemption without really giving too much up.

Although the term “GRIP” may be new, the technique isn't.¹ In fact, it's not really a technique at all but simply a partnership established with two types of interests—a preferred interest and a common interest—that carefully follows the rules imposed under Internal Revenue Code Section 2701 for the taxpayer's benefit. IRC Section 2701 is part of Chapter 14 of the

IRC, which is titled “Special Valuation Rules” and dictates that in certain circumstances, actual values are ignored and special values are imposed for estate and gift tax purposes. Section 2701 was enacted to regulate certain types of estate-planning transactions that “freeze” the value of a business entity—typically a partnership or limited liability company (LLC). When it applies, Section 2701 treats the taxpayer—or, for purposes of this article, the grantor, as having made a significant taxable gift even when what was actually gifted or transferred was a common interest that had no or minimal value. Instead, the grantor retains the preferred interest that's actually worth \$11.7 million and continues to hold, enjoy and benefit from it for life. On the grantor's death, this \$11.7 million preferred interest is included in the grantor's taxable estate. However, because the special valuation rules of Section 2701 had previously attributed \$11.7 million of value to the common interest that the grantor had gifted during life, the IRC and regulations protect the grantor from being taxed twice and direct that the estate be reduced by this \$11.7 million amount. The policy behind the reduction is that because the special valuation rules under Section 2701 had already treated the grantor as having gifted the value of the preferred interest during life, it wouldn't be fair to tax this same \$11.7 million again at the grantor's death.

Structure

The GRIP is essentially a traditional freeze partnership (that is, with preferred and common interests) that intentionally flunks Section 2701 to trigger the special valuation rules—or to put it into familiar estate-planning terms—an intentionally defective freeze partnership.² As such, the first steps in forming a GRIP look a lot like the first steps for a traditional freeze partnership. Namely, the grantor contributes



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property to a partnership or LLC, and in exchange, the grantor receives back two classes of interests—the preferred interest, which receives a preferred return, and the common interest, which receives the growth. In a traditional (or non-defective) freeze partnership, care is taken to avoid the special valuations rules of Section 2701, which operate to value the preferred interest at zero and instead attribute its value to the common interest (the deemed gift).³ This generally results in an unintended and significant taxable gift. To avoid the special valuation rules and the resulting deemed gift, the partnership must carefully comply with the rules set forth in Section 2701. For example, the common interest must have a minimal value of 10% of the partnership, and the preferred interest holder must receive a “qualified payment.”⁴

In a GRIP, the value of the property contributed to the partnership should be structured to be equal to or less than the amount of the grantor’s remaining applicable exclusion amount, which we’ll assume for illustration purposes is \$10 million. Under the partnership agreement, 99% (or \$9.9 million) may be allocated to the capital account of the preferred interest holder, and 1% (or \$100,000) may be allocated to the capital account of the common interest holder, both of which are initially owned by the grantor. The partnership agreement can provide that the grantor has a right to take back the grantor’s capital account at any time—this is referred to as a “put right.” Additionally, the preferred interest can receive a non-cumulative preferred return that can, for example, be 7%, indexed for inflation, on its capital account. In contrast, the common interest can be structured so that its value is minimal, only entitled to growth over the 7% non-cumulative preferred return.⁵

The key to a GRIP is making sure that you trigger the special valuation rules of Section 2701, thereby resulting in the imposition of the deemed gift. A simple way to do this is to make sure the preferred return isn’t a qualified payment by providing that it’s a *non-cumulative* preferred return—meaning, if the partnership doesn’t have sufficient earnings in a given year to pay the 7% return, the return lapses and doesn’t cumulate into the next year’s preferred payment.⁶ The grantor then gifts the common interest to a trust for the grantor’s spouse and descendants.⁷ Because the return on the preferred interest is non-cu-

mulative, the GRIP triggers the special valuation rules of Section 2701. Under the special valuation rules, the preferred interest—which has the unrestricted right to get back \$9.9 million and receive a non-cumulative 7% return—is valued at zero, while the common interest—which is only entitled to growth in excess of the 7% return—is valued at \$10 million. As such, the grantor’s entire \$10 million gift exemption would be used on the minimally valued common interest while the valuable preferred interest is retained by the grantor and is actually worth \$9.9 million.

For those clients who wish to freeze their estates in addition to locking in the increased estate tax exemption, the GRIP can function as a freeze vehicle.

When the grantor dies, the preferred interest is included in the grantor’s estate; however, because the grantor was already treated as giving away the \$10 million of value when the grantor gifted the common interest, as detailed below, Section 2701 and the applicable regulation thereunder contain a mitigation rule that provides for a reduction in the grantor’s estate of \$9.9 million.⁸ Thus, the GRIP effectively allows the grantor to use today’s current gift tax exemption to offset the value of the preferred interest in the grantor’s estate on death, regardless of the available transfer-tax exemption at such time. It also provides the grantor with customizable access and use of the preferred interest during the grantor’s life, and, at death, the ability to decide who receives the preferred interest. Additionally, because the preferred interest is included in the taxable estate, it should receive a step-up in basis under Section 1014.⁹

A Freeze Vehicle

For those clients who wish to freeze their estates in addition to locking in the increased estate tax exemption, the GRIP can function as a freeze vehicle as well.



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When valuing the assets being contributed to a GRIP, normal valuation rules may apply, including valuation discounts for lack of control and lack of marketability for contributed interests in entities, which are advantageous in freeze transactions and something clients may want to take advantage of in their current planning, as these type of valuation discounts may be eliminated by the Biden administration. Clients can select the hurdle rate they wish to use and index it to track interest rate indexes or inflation. Because the grantor is intentionally triggering the special valuation rules in a GRIP, the preferred return doesn't have to be a market rate of return and can be adjusted to reflect the client's particular estate-planning goals and cash flow needs. Thus, for clients that don't need significant cash flow from the assets contributed to the GRIP, the preferred return should be kept low so that assets aren't building up in their estate from the preferred return distributions. Instead, with a low preferred return rate, more growth will pass to the common interest, which, if structured properly, should pass outside the grantor's taxable estate.

When a GRIP is used as a freeze technique, and the common interest is anticipated to have meaningful value, care must be taken to ensure that Sections 2036 and 2038 aren't triggered.

IRC Sections 2036 and 2038 aren't a concern with respect to the preferred interest, as the GRIP already causes the preferred interest to be included in the grantor's estate. However, when a GRIP is used as a freeze technique, and the common interest is anticipated to have meaningful value, care must be taken to ensure that Sections 2036 and 2038 aren't triggered, thereby causing inclusion of the common interest

in the grantor's estate. For example, if the partnership agreement provides that the grantor is to receive back all of the income of the partnership rather than just a fixed preferred return, that would likely result in the inclusion of the entire partnership—including the common interest—in the grantor's taxable estate under Section 2036.¹⁰ Similarly setting the preferred return rate so high could be viewed as tantamount to retaining all income and causing inclusion under Section 2036. Also, funding the GRIP with virtually all of the grantor's assets (including the grantor's personal residence) presents the type of bad facts that could cause inclusion of the common interest in the grantor's estate. Additionally, if the partnership agreement gives the grantor powers over the allocation and distributions of profits among the partners, this may cause inclusion of the common interest under Section 2038. That is, the same type of analysis and care used in funding and structuring family limited partnerships and other freeze structures should also be employed with the GRIP to ensure the common interest isn't included in the grantor's taxable estate.

The Estate Reduction

The key to the estate tax savings of the GRIP is that the grantor's estate receives an offsetting reduction against the preferred interest because it will be included in the grantor's estate (the estate reduction). This essentially prevents the preferred interest from being subject to estate tax. Recognizing that the special valuation rules of Section 2701 would cause double taxation of the same asset—namely, attributing the value of the preferred interest to the gift of the common interest during life and then the subsequent inclusion of the preferred interest in the taxable estate at death—Congress directed the Treasury to issue regulations to formulate an adjustment so as to avoid this result.¹¹ Treasury responded with Treasury Regulations Section 25.2701-5, which provides an estate tax reduction when the grantor dies owning the preferred interest.¹²

Treas. Regs. Section 25.2701-5 details the estate reduction formula, which involves three steps:

Step 1. Calculate the amount by which the gift of the common interest was increased as a result of Section 2701 (this is the "deemed gift").¹³ In our



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illustration, because the preferred interest had a \$9.9 million put option—meaning the preferred interest holder could receive back \$9.9 million of the initial \$10 million contribution—the actual value of the preferred interest as of the date of the gift was valued at \$9.9 million,¹⁴ yet the special valuation rules of Section 2701 valued this at zero. As a result, the entire \$9.9 million of value is attributed to the common interest, and \$9.9 million is the deemed gift.

Step 2. Calculate the amount by which the value of the preferred interest as of the date of death exceeds the value of the preferred interest as of date of the gift of the common interest (note, the value of the preferred interest on the date of the common interest gift is generally zero, because the entire value of the preferred interest is allocated to the common interest under the special valuation rules) (the “duplicated amount”).¹⁵ In our illustration, so long as the grantor hasn’t exercised all or any portion of the grantor’s put option during life (that is, distributions to the grantor didn’t exceed the preferred return), and so long as the value of the assets in the GRIP haven’t decreased in value and could still support the grantor’s exercising the grantor’s \$9.9 million put option, then the value of the preferred interest at the grantor’s death should be this same \$9.9 million value that it was on the date of the gift of the common interest \$9.9 million.¹⁶ Thus, the duplicated amount is \$9.9 million.

Step 3. The estate reduction is equal to the lesser of the deemed gift or the duplicated amount.¹⁷ In our illustration, because the value of the preferred interest didn’t change, the deemed gift and the duplicated amount are the same values, and thus the estate reduction is \$9.9 million.

As a result, so long as the preferred interest doesn’t change in value, the estate reduction should always equal the entire \$9.9 million deemed gift. On the other hand, if the assets of the GRIP plummet and there are insufficient assets or expectation of growth to support the \$9.9 million put option at death, or if the grantor receives distributions during the grantor’s life reducing the grantor’s put option (and thus the capital account of the preferred interest), then the value of the preferred interest at death would be less than the deemed gift value of \$9.9 million, and the estate reduction would also be that lower amount. For example, assume that in addition to the pre-

ferred return, the grantor had exercised the grantor’s put option during life, receiving an additional \$2 million in distributions from the partnership. On the grantor’s death, the grantor’s capital account and put right would only be for \$7.9 million, resulting in the grantor’s preferred interest being valued at \$7.9 million. Likewise, the estate reduction would be \$7.9 million. Limiting the estate reduction to the value of the preferred interest at death makes sense because the goal is to avoid a double tax on the same asset.

To ensure the maximum estate reduction is preserved, the preferred interest should be structured so as to maintain the same value over the grantor’s life. This can generally be achieved by giving the grantor a put option over 99% of the initial value of the GRIP. However, the grantor should be mindful not to exercise the option beyond the grantor’s current needs, as any distributions from the GRIP in excess of the preferred return would reduce the estate reduction. The preferred interest can be generally regulated so as to prevent appreciation by customizing the rights retained by the grantor, such as limiting the put option to the value of the respective capital account and tying the preferred return to a recognized interest index (for example, London Interbank Offered Rate) or the applicable federal rate.

Generally, a subsequent decrease to the available exemption and the applicable credit shouldn’t impact the success of the GRIP.

Effect of Changing Exemption

Generally, a subsequent decrease to the available exemption and the applicable credit shouldn’t impact the success of the GRIP. As explained above, key to the GRIP structure is the estate reduction, which offsets the inclusion of the preferred interest in the grantor’s estate. Treas. Regs. Section 25.2701-5(a)(3) provides that the executor of an estate may “reduce the amount on which the decedent’s tentative tax is computed under section 2001(b) (or



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section 2101(b)) by the amount of the reduction.” Because the estate reduction reduces the “tentative tax” calculated under IRC Section 2001(b)(1), it shouldn’t be dependent on a higher exemption amount to offset the value of the deemed gift in the estate. As a result, the amount of the applicable credit in effect or available at the grantor’s death shouldn’t impact the estate reduction.

Further, the IRS issued regulations (the anti-clawback regs) to confirm that there will be no clawback of the higher applicable credit amount to the extent gifts were made during life, regardless of the amount of credit available at the taxpayer’s death.¹⁸ Although Treasury reserved the right to modify these regulations in the future for “anti-abuse” situations to prevent the application of the anti-clawback regs to gifts that are “not true inter vivos transfers but rather are treated as testamentary transfers for transfer tax purposes,” as explained above, because of the way the estate reduction applies, this shouldn’t impact the GRIP.¹⁹ However, even if it did, the grantor could simply gift the preferred interest during life, and the grantor would then receive an offsetting reduction for the lesser of the deemed gift and the value of the preferred interest on the date of the gift of preferred interest.²⁰

Determining whether to allocate GST tax exemption is particularly challenging with a GRIP.

While the anti-clawback regs shouldn’t make or break the success of the GRIP, a potential change to the regulation that details the estate reduction could jeopardize it. However, because the legislative history of Section 2701 suggests that it was Congress’ intent to avoid any double taxation of the deemed gift, and because Section 2701(e)(6) explicitly directs Treasury to prescribe regulations to prevent this, it appears that any changes to the regulations that would result in the deemed gift being subject to tax in the grantor’s taxable estate would most likely exceed the Congressional grant of regulatory authority under Section 2701(e)(6).²¹

GST Implications

Determining whether to allocate generation-skipping transfer (GST) tax exemption is an important consideration for any estate planning and is particularly challenging with a GRIP due to both the GST rules in Chapter 13 and the inconsistencies referencing those rules within Section 2701 and its regulations. However, this decision doesn’t need to be made until the gift tax return reporting the GRIP is due (that is, Oct. 15, 2022 for GRIPs done in 2021 when an extension is filed), so planners should build flexibility into the trust receiving the common interest to take advantage of this extra time to make this determination.

Unlike with a GRAT or a qualified personal residence trust, where GST tax exemption can’t be allocated until after the term expires because of the estate tax inclusion period, GST tax exemption can be allocated to the trust receiving the common interest (the family trust) because it shouldn’t be subject to estate inclusion in the grantor’s estate. Using our example of the \$10 million GRIP, the question arises, however, as to how much GST tax exemption the grantor needs to allocate to the family trust to make it fully GST tax exempt—the full \$10 million (which includes the value of the \$9.9 million deemed gift) or only \$100,000 (the presumed actual value of the common interest).

Under the GST rules, when allocating GST tax exemption to transfers made during life, the value used for GST purposes is the value determined under the gift tax rules of Chapter 12.²² Because Section 2701 values the common interest for gift tax purposes in our example at \$10 million, then it should follow that the full \$10 million of GST tax exemption should be required to make the family trust fully GST tax exempt. This is an inefficient use of GST tax exemption because \$10 million of GST tax exemption is being used on the common interest that may in fact never grow to anywhere near that amount over the grantor’s life. Further complications arise as a result of inconsistencies within the statutory and regulatory language of Section 2701, which raise doubts as to whether the deemed gift applies for GST tax purposes.²³ Additionally, leading commentary on Section 2701 indicates that the deemed gift may not be applicable for GST purposes.²⁴ As such, practitioners may be hesitant to allocate GST tax exemption to the GRIP and should fully apprise



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themselves of the risks involved in doing so.

Despite some uncertainty of whether \$100,000 or \$10 million of GST tax exemption is needed to make the family trust fully exempt from GST tax, the benefit of waiting until next October to decide about the allocation of GST can prove very helpful in certain situations. For those clients who've never used any GST tax exemption, so long as any change to the law leaves the client with at least \$100,000 of GST tax exemption for 2022, then that client needn't allocate GST tax on their timely filed 2021 gift tax return reporting the GRIP. Instead, they may wait until after Oct. 15, 2022 and file a late GST tax allocation to the family trust. This is because late allocations of GST aren't based on the value of the transfer as of the date of the gift (which may include the deemed gift amount) but instead based on the then-value of the common interest in the family trust that's not subject to the special valuation rules because no transfer is being deemed to be made at that time.²⁵ Also, for those clients who've already used significant GST tax exemption, if the law changes such that they'll lose all of their remaining GST tax exemption, they might as well allocate their remaining GST tax exemption on a timely filed return because they'll lose it anyway.

Application of State Law

Clients who are domiciled in states with gift and/or estate tax should consider the impact the GRIP will have on state taxes, including whether the estate reduction will be permitted for state estate tax purposes. States with estate tax that's tied to the federal regime should ensure that there's a sufficient connection between the state law and Section 2001(b), when the reduction operates to reduce the grantor's tax base.

For example, New York doesn't have a gift tax, and thus there's no deemed gift on the gift of the common interest for New York purposes, and likewise there's no estate reduction in the grantor's estate for New York estate tax purposes to offset the value of the preferred interest that will be included in the grantor's taxable estate.²⁶ Thus, the GRIP won't reduce the grantor's estate for New York purposes, and this may be an important consideration for those who are seeking to avoid the so-called "New York cliff" as the GRIP wouldn't accomplish this. Also noteworthy is that for estates subject to both federal and New York estate

tax, the increase in overall transfer taxes that results from gifts made within three years of date of death should have limited applicability to the GRIP.²⁷ This is because the New York gross estate is only increased by the value of any taxable gift under Section 2503 made within three years prior to death if such gift isn't otherwise included in the grantor's federal gross estate under Section 2031.²⁸ However, because the value of the common interest isn't included in the grantor's federal estate (provided the GRIP was structured properly, as discussed above), it will be included in the New York gross estate for estate tax purposes. Thus, if the grantor anticipates a large appreciation in value over the three years following the gift, consider the state tax consequences.

Even if the STEP Act is enacted and retroactive to all gifts made this year, it will most likely have little to no effect on the GRIP.

Application of STEP Act

The STEP Act was introduced earlier this year by Senator Van Hollen, and if enacted, is stated as being retroactively effective as of the beginning of 2021. As a result, it may be important to keep this retroactivity in mind when engaging in planning this year. The STEP Act includes proposals that would eliminate the Section 1014 basis adjustment at death and trigger capital gains tax on unrealized appreciation in assets transferred by gift. There are several exclusions, including gifts to trusts that are included in the grantor's estate, along with a \$1 million exemption (\$100,000 of which is available for lifetime gifting). As a result, if enacted, the STEP Act would retroactively trigger a capital gains tax on the built-in gain in assets gifted to intentionally defective grantor trusts made this year. With respect to the GRIP, the STEP Act would most likely only trigger a gains tax on the appreciation in the common interest being gifted to a trust (that isn't included in the grantor's estate), which will generally have little to no value




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and would be covered by the available exemption. The Section 2701 deemed gift most likely won't trigger a capital gains tax under the STEP Act, as the proposed capital gains tax would only be triggered when a transfer has taken place for income tax purposes, and there's no indication that it would apply to a deemed gift that applies for gift tax purposes. Further, the Section 2701 deemed gift is included in the grantor's estate, which is an exception to the application of the gains tax. As a result, even if the STEP Act is enacted and retroactive to all gifts made this year, it seems like it should have little to no effect on the GRIP, given the limited application to the common interest that will generally have no meaningful value.

Take care to ensure that the preferred interest maintains its value to maximize the estate reduction while also being mindful not to trigger estate tax inclusion of the common interest.

Effective Technique

The GRIP can be a valuable estate-planning technique for those clients who want to lock in what's remaining of their \$11.7 million exemption but who can't afford to do so or are otherwise not willing to relinquish using and accessing such property. In structuring a GRIP, take care to ensure that the preferred interest maintains its value to maximize the estate reduction while also being mindful not to trigger estate tax inclusion of the common interest. Also, carefully analyze the GST and state tax implications. With these considerations in mind, the GRIP may be a great option for many clients looking to do planning in these uncertain times. 

Endnotes

1. See Carlyn McCaffrey and Jonathan Blattmachr, "The Estate Planning Tsunami of 2020," 47 *Est. Plan.* 4 (2020); S. Stacy Eastland, "Best Estate Planning Techniques

Under TCJA—Part 5: IDPIP," 45 *Est. Plan.* 14 (2018); Christopher Pegg and Nicole Seymour, "Rethinking I.R.C. §2701 In The Era Of Large Gift Tax Exemptions," *Florida Bar Journal*, Vol. 87, No. 9 (2013).

2. The grantor retained interest partnership (GRIP) structure has been referred to as an "intentionally defective freeze partnership," McCaffrey and Blattmachr, *ibid.*
3. The amount of the deemed gift is determined under the subtraction method, which is detailed in Treasury Regulations Section 25.2701-1(a)(1).
4. This results in the preferred return not being a qualified payment. Note that regardless of the terms of the partnership agreement, you can elect in or out of qualified payment status on the gift tax return for the year of the "transfer"—which is usually the year the partnership is formed or recapitalized creating the common and preferred interests. See Treas. Regs. Section 25.2701-3(c).
5. There should be a reasonable prospect for the common interest to receive income during the lifetime of the grantor to minimize the application of Internal Revenue Code Section 2036.
6. This results in the preferred return not being a qualified payment. Note, regardless of the terms of the preferred payment, the grantor can elect out of qualified payment status. See *supra* note 4.
7. IRC Section 2701 only applies to transfers to or for the benefit of a member of the family, which includes descendants but doesn't include descendants of siblings. Thus, if the common interest was gifted to a trust for nieces or nephews or unmarried partners, the GRIP would fail to trigger the special valuation rules, and there would be no deemed gift. See Treas. Regs. Section 25.2701-1(d). Note that a gift of the common interest isn't the only way to trigger the special valuation rules of Section 2701, because transfers are broadly defined to include recapitalizations or capital shifts. Although beyond the scope of this article, a recapitalization with preferred and common interests rather than a gift of the common interest is an alternative method for triggering Section 2701 when the assets contributed to the partnership have debt in excess of basis. See Stephen M. Breystone, Mary P. O'Reilly and Jerome M. Hesch, "Effective Succession Planning Strategies for Owners of the Successful Pass-Through Business Entity," NYU School of Continuing and Prof'l Studies, 78th Inst. on Fed. Taxation (2019).
8. Section 2701(e)(6); Treas. Regs. Section 25.2701-5.
9. Assuming the basis adjustment under IRC Section 1014 isn't eliminated. Note the partnership can be structured to allocate the partnership liabilities to the preferred interest, including any liabilities in excess of basis, so that the basis step-up would include any so-called "negative capital." See Stephen M. Breystone, "Estate Planning for Negative Capital," *Trusts & Estates* (May 2012) for a detailed discussion on structuring a freeze partnership to maximize the step-up in basis attributable to the preferred interest. Note, one of the Democratic proposals would be to eliminate any step-up in basis at death, so this benefit of the GRIP would be lost in the event that's enacted.
10. See *Estate of Powell*, 148 T.C. 392 (2017), in which the court held that a decedent's right to amend a limited liability agreement with the consent of all the other members was a retained interest within the meaning of Section 2036(a)(2).
11. Section 2701(e)(6).

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12. Note that a similar gift tax reduction is given when the grantor gifts the preferred interest during life rather than holding it until death.
13. See Treas. Regs. Section 25.2701-(b)(1).
14. Because we're currently in a low interest rate environment and the preferred interest in our illustration was entitled to a 7% preferred rate of return, it's possible that the value of the preferred interest is actually above \$9.9 million but would be worth no more than \$10 million because that's the entire value of the partnership. Thus, the deemed gift could potentially be between \$9.9 million and \$10 million, and an appraisal should be obtained if a value of over \$9.9 million will be claimed.
15. See Treas. Regs. Sections 25.2701-(a)(3), 25.2701-(b)(2) and 25.2701-(c).
16. Note that if the grantor dies in a low interest rate environment, because the preferred interest is entitled to a 7% preferred return, the preferred interest may be worth more than \$9.9 million because the market at that time would attribute more value to that type of return.
17. See Treas. Regs. Section 25.2701-(b).
18. See Treas. Regs. Section 20.2010-1.
19. See preamble to Treas. Regs. Section 20.2010-1(c), Estate and Gift Taxes; Difference in the Basic Exclusion Amount, 84 FR 64995-01.
20. See McCaffrey and Blattmachr, *supra* note 1 and *Steve Leimberg's Estate Planning Email Newsletter* (Sept. 3, 2020), which raises as a potential risk to the GRIP structure the Internal Revenue Service or Treasury making this change to the anti-clawback regulation but concludes that if that change were to happen, the risk could be avoided by gifting the preferred interest shortly before death. Note that there are restrictions as to whom the grantor can gift the preferred interest while also receiving the gift reduction.
21. See H.R. 5835 (S. 3209), 101st Cong., 2d Sess. (Oct. 18, 1990); H.R. 3448, 104th Cong., 2nd Sess. (May 22, 1996).
22. See Section 2642(b)(1)(A).
23. Treasury appears to take the position that the special valuation rules of Section 2701 don't apply for purposes of valuing generation-skipping transfers (GSTs), as the preambles to the proposed and final Section 2701 regulations are stated as being applicable to Chapters 11 and 12 alone (not Chapter 13). See PS-92-90, 56 Fed. Reg. 14321 (April 9, 1991). However, in Section 2701(e)(6), Congress specifically charged Treasury with the task of avoiding double taxation by making "appropriate adjustments ... for purposes of chapter 11, 12, or 13." However, Treasury responded with Treas. Regs. Section 25.2701-5, which only addresses the reduction for estate and gift tax purposes. While comments to the initial draft of Section 2701 in the Omnibus Budget Reconciliation Act of 1990 raised questions as to the GST tax consequences arising from a deemed gift, Congress didn't address this issue.
24. See Carol A. Harrington, "Generation-Skipping Transfer Tax," *BNA Portfolio* 850-2nd: Detailed Analysis, K, Chapter 14. See also Eastland, *supra* note 1.
25. See Section 2642(b)(3)(A).
26. Pursuant to New York Tax Law Sections 954-955, the New York taxpayer's "gross estate" means their federal gross estate as defined in Section 2031 increased by the value of any taxable gift under Section 2503 made within three years prior

to death, and the "taxable estate" means the decedent's gross estate less any deductions allowed for purposes of calculating the decedent's federal taxable estate (that is, Sections 2032(b), 2046, and 2053-2056). Because the New York "taxable estate" doesn't incorporate Section 2001(b) (when the reduction is applied) it appears that the New York estate tax calculation wouldn't receive the Section 2701 reduction.

27. See New York Tax Law Section 954(a)(3). Gifts made within three years of death are added back into the New York taxable estate. However, for federal purposes, because these are gifts, there's no deduction for state estate tax purposes. This typically results in the combined federal and New York estate taxes being more than if the gift wasn't made within three years of death. However, if the grantor dies within three years of gifting the common interest, this shouldn't be much of a concern because the value of the common interest is usually structured as having a minimal value.
28. *Ibid.*



SPOT LIGHT

Feathered

Pájaro de poder by José Bedia sold for \$2,750 at Christie's Latin American Art Online auction on July 9-23, 2021 in New York. Bedia was born in Cuba but currently resides in Florida. His large-scale paintings are inspired by his Santería faith, and his works frequently depict mythical elements, altars and other sacramental imagery. Notably, Bedia represented Cuba at the prestigious Venice Biennale in 1990.