Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2909

Date: 27-Sep-21
From: Steve Leimberg's Estate Planning Newsletter
Subject: Thomas A. Tietz, Martin M. Shenkman, and Jonathan G. Blattmachr: Recission - Considerations and Applications for Planning in 2021

"On August 10, 2021, the Senate passed by a vote of 69-30 a $1.2 trillion infrastructure package. While this bill still has to go through the reconciliation process and approval of the House of Representatives, this reflects progress being made in Washington D.C. towards the Democratic legislative initiatives and goals that have been pushed by President Biden and his administration. Numerous plans and proposals have been put forward which include various changes to the tax structure that would significantly impact estate planning, and the Senate is currently debating an additional $3.5 trillion reconciliation-based infrastructure and social funding plan. While that blueprint does not include any specifics proposals on tax increases that would be included to pay for the cost of the bill, it is possible that it will include modified versions of several of the tax changes from previous proposals.

While it is impossible to determine exactly what, if any, changes to the tax code will be enacted, many practitioners have urged their clients to plan proactively and avoid a 'wait and see' strategy, due to the chance such a strategy would result in 'wait and pay.' However, with the fact that several of the proposals include enactment dates that are either retroactive (i.e., effective back until January 1, 2021) or on "date of announcement" of a proposal, which could be viewed to have already passed, there is a possibility that the opportunity to plan has already passed.

The amount of uncertainty in planning during this period has necessitated practitioners needing to consider ways to provide clients with the ability to plan under the current estate taxation planning environment, while also including mechanisms in that planning wherein a transaction can be either rescinded or unwound in an attempt to avoid an unfavorable tax result due to legislative changes that may or may not be enacted at a later date.

There have been several techniques that have been discussed for practitioners to consider employing, such as including a disclaimer in trust documents using formula clauses in assignment and transfer documentation, etc. Recission is an additional technique that practitioners might consider including in their toolkit to employ when trying to plan for the level of uncertainty that has to be dealt with for transactions completed before legislation is enacted. Recission may offer a means to unwind a transaction in the current tax year and thereby avoid a possible income tax consequences to a transfer. Because of the proposed retroactive effective date contained in Senator Van Hollen's proposal, recission has received more attention. This newsletter will explore the recission mechanism and raise considerations in its application in the current planning environment."

Thomas A. Tietz, **Martin M. Shenkman** and **Jonathan G. Blattmachr** provide members with commentary that examines how the doctrine of recission could be used to unwind transactions in the current tax year and thereby avoid a possible adverse income tax consequences. Members will find their commentary most helpful as it contains specimen drafting language.

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

Thomas Tietz, JD, is an Associate with **Shenkman Law**. He is experienced in assisting with the implementation of all facets of an estate plan, including the preparation of core documents such as the Last Will and Testament, Health Care Proxy, Durable Power of Attorney, to the more advanced techniques of an Irrevocable Life Insurance Trust, Grantor Retained Annuity Trust, self-settled Trusts, and the implementation of asset

transfers to those trusts, depending on the client's needs. In addition to Estate Planning, he assists clients with estate administration, including the organization of the documentation and assets of a decedent for tax filings and disbursement, as well as assisting with corporate work, concentrating on the effects to family entities and businesses in relation to estate planning, including assisting with entity documents and complex entity ownership.

Jonathan G. Blattmachr is **Director of Estate Planning** for **Peak Trust Company** (formerly Alaska Trust Company), co-developer of **Wealth Transfer Planning**, a computer system for lawyers, published by Interactive Legal Systems and its Editor-in-Chief, director of Pioneer Wealth Partners, LLC, author or co-author of nine books and over 500 articles, and a retired member of Milbank, LLP, and of the Alaska, California, and New York Bars.

Here is their commentary:

EXECUTIVE SUMMARY:

On August 10, 2021, the Senate passed by a vote of 69-30 a $1.2 trillion infrastructure package.[i] While this bill still has to go through the reconciliation process and approval of the House of Representatives, this reflects progress being made in Washington D.C. towards the Democratic legislative initiatives and goals that have been pushed by President Biden and his administration. Numerous plans and proposals have been put forward[ii] which include various changes to the tax structure that would significantly impact estate planning, and the Senate is currently debating an additional $3.5 trillion reconciliation-based infrastructure and social funding plan.[iii] While that blueprint does not include any specifics proposals on tax increases that would be included to pay for the cost of the bill, it is possible that it will include modified versions of several of the tax changes from previous proposals.[iv]

While it is impossible to determine exactly what, if any, changes to the tax code will be enacted, many practitioners have urged their clients to plan proactively and avoid a “wait and see” strategy, due to the chance such a strategy would result in “wait and pay.” However, with the fact that several of the proposals include enactment dates that are either retroactive (i.e., effective back until January 1, 2021) or on “date of announcement” of a proposal, which could be viewed to have already passed, there is a possibility that the opportunity to plan has already passed.

The amount of uncertainty in planning during this period has necessitated practitioners needing to consider ways to provide clients with the ability to plan under the current estate taxation planning environment, while also including mechanisms in that planning wherein a transaction can be either rescinded or unwound in an attempt to avoid an unfavorable tax result due to legislative changes that may or may not be enacted at a later date. There have been several techniques that have been discussed for practitioners to consider employing, such as including a disclaimer in trust documents, using formula clauses in assignment and transfer documentation, etc. Recission is an additional technique that practitioners might consider including in their toolkit to employ when trying to plan for the level of uncertainty that has to be dealt with for transactions completed before legislation is enacted. Recission may offer a means to unwind a transaction in the current tax year and thereby avoid a possible income tax consequences to a transfer. Because of the proposed retroactive effective date contained in Senator Van Hollen’s proposal,[v] recission has received more attention. This newsletter will explore the recission mechanism and raise considerations in its application in the current planning environment.

COMMENT:

History and Applications of Recission

Recission,[vi] the concept of treating a transaction as void ab initio, may have been first discussed as being used for tax purposes in the United States Court of Appeals decision of Penn v. Robertson,[vii] but it was in 1980 with Rev. Rul. 80-58[viii] that the IRS provided formal steps to be taken to effectuate a recission for income tax purposes, stating that a recission must:

1. Take actions that would end with "*restoring the parties to the relative positions that they would have occupied had no contract been made.*"

2. The actions must be taken within the same tax year in which the transaction initially took place.[ix]

Beyond these two requirements, the Revenue Ruling provides flexibility for how parties could go about completing a recission. For example, one does not need the consent of all involved parties to have an effective recission.[x] However, it should be noted that Penn involved a rescission due to action taken by a third party and Rev. Rul. 80-58 involved a situation where the parties agreed that, if certain events did not occur, the transaction would be rescinded. Nonetheless, private letter rulings (which under Section[xi] 6110(k)(3) cannot be cited or used as precedent) indicates that recissions, in general, will be respected if effected in the same year that the underlying transaction took place.

While the IRS currently has a no-rule policy in place for recission for private letter rulings (PLRs),[xii] before the policy was put in place numerous PLRs were provided that help illustrate the breadth of the application of recission.[xiii] Several of those PLRs include:

1. PLR 200923010 discusses the recission of a distribution of stock from a corporation to its subsidiary. The IRS allowed the recession after going into detail how the recission agreement would bring all entities and parties back to the position they were in before the distributions were made.[xiv]

2. PLR 200533002 included a sale of S-Corporation stock in a manner that without recission would have resulted in the termination of the S-Corporation status. The IRS allowed the recission of the sale and confirmed that the S-Corporation was never lost as the recission actions were taken within the same taxable year as the sale took place.

3. PLR 200911004 permitted the recission of a merger between corporations that would have caused significant adverse tax consequences[xv] and instead have a sale transaction take place between the entities.

The facts of the Rev. Rul. 80-58 included an external event trigger for the recission based upon the obtaining a zoning change and the buyer and seller agreed that a rescission could occur if the change was not obtained. In the Ruling that event was an act by an unrelated third party zoning board: "…if at any time within nine months of the date, of sale, B was unable to have the land rezoned for B's business purposes…" However, the PLRs noted above seem to suggest in some cases the IRS approves of recission simply due to adverse tax consequences for the actions taken.[xvi] Consider whether adverse tax consequences due to a change in tax laws suffice to qualify as grounds for recission? Practitioners should consider cautioning clients that include a recission trigger in documents or are considering a recission of a transaction before the end of the year, that there may be a risk the IRS might argue that a change in the tax law is not equivalent to a zoning change by a third party.

The PLRs help illustrate the flexibility of situations recission has been used in to avoid unfavorable income tax results in the past. How to apply the technique to the unique challenges of 2021 planning is an issue practitioners should consider carefully.

What about the Gift Tax Effects of a Recission Provision in the Document?

One issue to consider is whether a recission provision in a document renders the transfer incomplete for gift tax purposes. Although the most "direct" way to have a transaction ignored for gift tax purposes is by a qualified disclaimer defined in Section 2518, the provision is limited to wealth transfer (e.g., gift and estate) tax purposes, not income tax purposes.

It seems that a unilateral right of a donor to rescind a transfer renders the gift incomplete for gift tax purposes. Treas. Reg. 25.2511-2(b) provides, in part, "a transfer of property (whether in trust or not may be partially complete and partially incomplete, depending upon all the facts in the particular case. *** A gift is … incomplete if and to the extent that a reserved power gives the donor the power [without the consent of an adverse party] to name new beneficiaries or to change the interests of the beneficiaries as between themselves…."

Perhaps, there is "no harm" in providing that the parties can rescind a transaction including for wealth transfer tax purposes, but the provision might render the transfer at the time it is made incomplete. Allowing only one party (e.g., the donor) to rescind the transaction might, therefore, render the gift incomplete. Although it is arguable that the donee would be adverse to that, the fact that the donee agreed to allow the donor to rescind might be held to render the donee non-adverse.

Would providing that the transaction can or is rescinded only if there is (or is not) a particular tax change, e.g., a retroactive application of a deemed realization rule, suffice to deflect an argument that the transfer was incomplete for gift tax purposes? Might such a self-executing mechanism be viewed as outside of the purview of the donor as it is based on actions of Congress not the donor?

Drafting Documents Including Potential Recission Before the End of 2021[xvii]

Rev. Rul. 80-58 included a specific trigger in the sale documents for conditions under which recission would take place.[xviii] While the PLRs discussed above did not all include a trigger in the documentation for the transaction being rescinded, practitioners should consider incorporating these triggers into any future documents for clients that they believe may desire to employ recission if the tax laws are changed before the end of the year.

As another consideration, many practitioners have indicated that they are seeing a significant increase in clients wishing to complete planning before any changes to the law, and the crush of work is likely to increase significantly as year-end approaches. If legislation is passed close to the end of the year, practitioners may not have enough time to complete documentation to implement recission for all of the transactions completed before the end of the year for which clients wish to rescind. However, by including a provision for recission in the documents, practitioners will have the option to include a self-executing automatic trigger in which the transaction is rescinded if, as an example, legislation is passed that causes an adverse tax result to take place due to the transaction. However, having documents prepared ahead of time so they can be "instantly" implemented might be a "safer" approach. For example, if the property owner intends to transfer appreciated assets (by gift or by sale to a grantor trust which under current law would not trigger gain recognition by reason of Rev. Rul. 85-13 but might under legislation adopted later this year), the trust to which the transfer would take place could be transferred could be executed by the trustees and expressly provide that the trust would not be created and irrevocable unless and until the grantor signs. Similarly, the document of transfer (e.g., a stock power for shares of stock or a deed of real property) could be ready for signing by the grantor. If legislation is drafted, is virtually certain to be signed into law by the President and contains an adverse provision (e.g., gain recognition which is retroactive to the date of

enactment or an earlier date), the grantor simply would not execute the documents of transfer (e.g., the trust). On the other hand, if transactions pre-dating the date the President signs the law (noting the Senator Sanders bill ["For the 99.5%"] contains provisions that would be effective as of the date of enactment (that is, the date the President signs the measure into law), the grantor could sign the documents the date before.

This, in turn, raises the question of whether the documents could effectively provide that they are revocable if the law does (or does not) contain a provision that would be adverse or not. That should not render the gift incomplete as the donor does not hold the power to rescind—it would automatically occur.

Sample Language. "***Recission of Transaction****. If, during the calendar year in which this Agreement has been signed, legislation is passed in which the Internal Revenue Code is modified which has the effect of causing the [transaction] herein to be considered a recognition event for federal income tax purposes, the Parties agree to take the following actions immediately, and within the same tax year as the Transaction was completed (and if the parties to the transaction have different tax years, the earlier of such years)*[xix]*: (a) the Note*[xx] *given by [buyer] to [seller] is thereupon voided, and (b) the assignment and transfer documents [list actual name and date] are deemed void, and (c) any down payment provided by the buyer to the seller [delete for gift] shall be due and payable to the buyer by the seller from the date of the initial transfer bearing interest*[xxi] *at the short term applicable federal rate from the date of the initial transfer until repaid in the current tax year. To avoid any doubt, the Parties intend for this provision to effectuate a recission of the Agreement pursuant to Rev. Rul. 80-58, 1980-1 C.B. 181 and agree to take any actions reasonable and necessary to conform the actions taken under this provision if triggered to complete the recission, with the same effect as though the transaction had never occurred.*[xxii]"

Given the potentially incredible work-load that may face practitioners at the end of 2021, why not make the recission provisions self-executing as

discussed above to avoid the risk of a client contacting counsel and counsel not having time to complete the transaction?

While ideally all necessary or advisable legal documentation to unwind the transaction should all be completed, it may suffice to rely on the self-executing provisions if the supporting documents cannot be completed in time. If there is sufficient time to complete documentation confirming the recission, practitioners could consider completing the following:

1. Cancellation of any promissory notes.

2. Refund of the down payment, and any documentation prepared to reflect the return of the monies (copy of a check, confirmation of a wire transfer, etc.)

3. Payment of any interest due to the buyer from the seller for the period the down payment was held by the seller. As noted above, some may question whether the payment of interest is consistent with the recission doctrine.

4. Cancellation of the sale contract.

5. Cancellation of any guarantees, escrow agreements, pledge agreements, or other supporting documentation for a sale transaction.

6. Assignment from buyer back to seller of the entity or asset interests involved [effective as of the initial transfer date].

Communicating with Clients

With the significant uncertainty in what, if any, legislation will be enacted before the end of the year, practitioners should consider communicating

with any clients that may be contemplating completing transactions before the end of the year. Some of the topics that can be communicated include:

1. There is no guarantee of the effect of any planning that is implemented, including the initial transaction as well as any steps taken to unwind a transaction in the event of adverse tax legislation that would affect the transaction.

2. Provide clients with options for both the kinds of transactions they can complete, as well as options for techniques they can use to unwind a transaction if needed. Appraising a client of the risks inherent in the options that they choose can assist a client with making an informed decision about what they want to do, as well as potentially protect a practitioner if planning does not achieve the results a client desired.

3. Discuss any issues or concerns each of the options provided may have in their implementation. For example, regarding recission if an automatic trigger is used as discussed above, then the transaction would be voided even if the tax changes result in a minor tax cost the client may have otherwise been comfortable bearing in order to have the transaction completed. However, if a client chooses not to have an automatic trigger, then they would have a risk of being unable to complete recission in time to meet the end of the taxable year deadline.

4. Inform clients of the potential of retroactive tax legislation, or other implementation dates such as date of announcement, which could mean that the potential for planning has already passed. Helping clients understand the uncertainty and flux that planning is in at this time will help set their expectations as we get closer to the end of the year.

5. As more information is received from Washington and any proposals include more definitive outlines of potential changes as the year moves on, communicate the effect those proposals may have on any planning they have in process or any planning they have been contemplating.

While the amount of work that may be available over the next several months is an opportunity for practitioners, it also has the risk of clients

committing to planning for which they may not understand the risks and issues with. Clear communication by the practitioner may help protect that practitioner from clients who have remorse over planning they have completed, or chosen to unwind, or did not have the opportunity to unwind through the end of the year.

Conclusion

Clients may have opportunities to take advantage of the current tax laws before any changes are implemented. Recission is one component of the toolkit practitioners can present to clients for achieving goals in this uncertain environment.

While the volume of work that this could present is an opportunity, practitioners should be cautious to communicate to clients the options that they have, the risks with those various options, as well as options such as recission that they may have to unwind any transactions completed if the tax laws change in an unfavorable manner.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Tom Tietz

Martin Shenkman

Jonathan Blattmachr

CITE AS:

LISI Estate Planning Newsletter #2909 (September 27, 2021) at http://www.leimbergservices.com. Copyright 2021 Leimberg Information Services, Inc. (**LISI**). Reproduction in Any Form or Forwarding to Any Person Prohibited - Without Express Permission. This newsletter is designed to provide accurate and authoritative information regarding the subject matter covered. It is provided with the understanding that **LISI** is not engaged in rendering legal, accounting, or other professional advice or services. If such advice is required, the services of a competent professional should be sought. Statements of fact or opinion are the responsibility of the authors and do not represent an opinion on the part of the officers or staff of **LISI**.

CITATIONS:

---

[i] For more information on the infrastructure package passed by the Senate, see https://www.cnn.com/2021/08/10/politics/bipartisan-plan-infrastructure-vote-congress/index.html

[ii] Senator Sanders (I. VT)proposed the "For the 99.5 Percent" Act, Senator Van Hollen (D. MD) and others proposed the Sensible Taxation and Equity Promotion (STEP) Act, President Biden's administration provided several proposals in the General Explanation of the Administration's Fiscal Year 2022 Revenue Proposals, among other proposals.

[iii] A blueprint plan for the Bill was passed on August 11, 2021. See https://www.nytimes.com/2021/08/11/us/politics/senate-budget-plan.html

[iv] For an initial analysis of some of the changes that may affect estate planning, See, e.g., Jonathan G. Blattmachr & Carlyn S. McCaffrey, “The Estate Planning Tsunami of 2020,” 47 Estate Planning 3, 10 (November 2020); Al W. King, Charlie Ratner, Richard Harris & Martin Shenkman, “President Biden's Budget Includes Big Tax Increases - What You Can Consider for Your Clients Now.”

[v] https://www.vanhollen.senate.gov/news/press-releases/van-hollen-leads-colleagues-in-announcing-new-legislation-to-close-the-stepped-up-basis-loophole .

[vi] For an in-depth review of recission as it is applied to the tax world, see “Rescission Doctrine Provides Opportunity for Tax Do-Overs” by Timothy J. McCormally, J.D., Washington, published on June 1, 2015, accessed on https://www.thetaxadviser.com/issues/2015/jun/tax-clinic-05.html.This reference and author description needs to be cleaned up.

[vii] Penn v. Robertson, 115 F.2d 167 (4th Cir. 1940).

[viii] Rev. Rul. 80-58; 1980-1 C.B. 181; 1980 IRB LEXIS 502.

[ix] Rev. Rul. 80-58 states “*the annual accounting period principle requires the determination of income at the close of the taxable year without regard to subsequent events*.”

[x] Specifically, Rev. Rul. 80-58 comments "*A rescission may be effected by mutual agreement of the parties, by one of the parties declaring a rescission of the contract without the consent of the other if sufficient grounds exist, or by applying to the court for a decree of rescission.*"

[xi] Throughout this article, "Section" refers to a section of the Internal Revenue Code of 1986, as amended.

[xii] Rev. Proc. 2012-3 (Section 5.02) initially started the no-rule policy, which was affirmed in Rev. Proc. 2014-3 and reaffirmed Rev. Proc. 2015-3. But not subsequent years?

[xiii] While a PLR is not considered binding on the IRS for anyone other than the taxpayer requesting the PLR and cannot be used as precedence (Section 6110(k)(3)), they can be used to understand the viewpoint of the IRS and practices to consider when considering using recission.

[xiv] In the representations, point 2, there was significant discussion of how exactly the parties would be brought back to their initial positions: "*Controlled has not paid any consideration other than the distributed shares of Controlled to Shareholder in connection with the distribution and Shareholder has not made any capital contribution to Controlled since the distribution. No such consideration will be paid by Controlled, and no such capital contribution will be made prior to the rescission. Therefore, no transactions between Shareholder and Controlled, as shareholder and direct subsidiary respectively, other than the distribution itself, will need to be reversed in order to effect the rescission.*"

[xv] As it is indicated in the PLR: "*Sometime in the next few months, Acquiring discovered that the merger of Target into Acquiring could yield adverse tax consequences that potentially could be devastating to the*

viability of Acquiring as an ongoing entity. After learning of these consequences, Acquiring, Target, and certain shareholders of Target undertook steps to rescind the merger and effect a taxable sale of the Target common stock to Acquiring."

[xvi] PLR 200911004. However, note that the adverse tax consequences were significant enough to endanger the continued existence of the merged entity as a business.

[xvii] The authors are simply providing recommendations for practitioners to consider and are not arguing for steps to be considered as best practices when using recission.

[xviii] The ruling included the following information on the language incorporated into the contract: "*The contract of sale obligated. A, at the request of B, to accept reconveyance of the land from B if at any time within nine months of the date, of sale, B was unable to have the land rezoned for 5's business purposes.*"

[xix] Note that a tax year may occur before the end of what would be the normal end of a taxpayer's tax year, such as in the event of death of an individual.

[xx]This section needs tailoring for the specific transaction that is contemplated for the recission provision. If there are transaction documents other than a promissory note (or in lieu of a note), they should be referenced in the provision.

[xxi] Practitioners should consider whether the payment of interest is consistent with the recission doctrine, and if they wish to have any provisions they include in transaction documents require the payment of interest.

[xxii] Evaluate the possibility of someone (e.g., a creditor) attaching a lien or judgment to the property transferred before the recission takes place.

Click here to comment on this newsletter.

HELP US HELP OTHERS! TELL A FRIEND ABOUT OUR NEWSLETTERS. JUST CLICK HERE.

Click Here for Steve Leimberg and Bob LeClair's **NumberCruncher** and **Quickview** Software, Books, and Other Resources