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Please Address Reply to:

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August 2, 2019

Internal Revenue Service
Office of Associate Chief Counsel (International) (Branch 2
Attention: Leni C. Perkins, Natalie Punchak and Karen J. Cate
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

Re: Reg. §1.965-7(b)(3) and (c)(3)

Dear Ms. Perkins, Ms. Punchak and Ms. Cate:

The American College of Trust and Estate Counsel ("ACTEC") wishes to submit comments on issues related to Treasury Regulation §1.965-7(b)(3) and §1.965-7(c)(3). These regulations define events that may accelerate the due date for payment of tax that has been deferred as a result of an election made under section 965(h) or section 965(i).

ACTEC is a professional organization of approximately 2,500 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift and GST tax planning, fiduciary income tax planning and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

ACTEC's comments on the difficulties posed under the above-referenced regulations for individuals, estates and trusts to avoid accelerating the tax imposed by section 965 that have been deferred pursuant to section 965(h) or 965(i) and ACTEC's recommendations for alternative rules are set forth in the attached memorandum.

If you or your staff would like to discuss the comments, please contact Ellen Harrison, who drafted these comments, at (202) 756-8635 or eharrison@mwe.com, Donald Kozusko, Chair of the ACTEC Washington Affairs Committee at (202) 457-7211 or dkozusko@kozlaw.com or Deborah McKinnon, ACTEC Director, at (202) 684-8460 or domckinnon@acteg.org.

Respectfully submitted,

John A. Terrill, II
ACTC President 2019-2020

Enclosure

COMMENTS OF THE AMERICAN COLLEGE OF TRUSTS AND ESTATES COUNSEL
ON ISSUES RELATED TO SECTION 965(h) AND 965(i) AND
TREAS. REG. §1.965-7(b)(3) AND §1.965-7(c)(3)

I. The Transition Tax on Specified Foreign Corporations - §965

One of the most significant changes in the law made by the TCJA is the enactment of section 965, a transition tax on U.S. Shareholders (as defined for purposes of the CFC rules) of specified foreign corporations (SFC). An SFC is a controlled foreign corporation (CFC) or any other foreign corporation that has a domestic corporate shareholder that is a "U.S. Shareholder" as defined for purposes of the CFC rules, except that a passive foreign investment company is not a SFC.[1] A U.S. Shareholder is a person who owns, directly, indirectly or constructively, shares representing at least 10% of the vote or value of a foreign corporation.[2] A CFC is a foreign corporation if more than 50% of the vote or value of shares are owned, directly, indirectly or constructively, by U.S. Shareholders.

This new law requires both corporate and individual U.S. Shareholders, as defined for purposes of the CFC rules, of a SFC to include in gross income such shareholder's share of all post-1986 previously untaxed accumulated earnings of a specified foreign corporation measured as of November 2, 2017 or December 31, 2017, whichever is greater, that was owned by the U.S. Shareholder in the last taxable year which begins before January 1, 2018 (the transition year). In the case of a taxpayer who is on a calendar year, the transition year is calendar year 2017. This amount is taxed as subpart F income. A U.S. Shareholder's share of deficits of SFCs offsets the amount includable in income.[3]

The transition tax is imposed at a reduced rate.[4] To the extent the specified foreign corporation's assets consist of assets other than cash and cash equivalents, the maximum tax rate is an "8 percent equivalent percentage"[5] and to the extent of the specified foreign corporation's investments consist of cash and cash equivalents, the maximum tax rate is a "15.5 percent equivalent percentage."[6] The equivalent percentages are achieved by allowing a deduction under section 965(c) sufficient to reduce the tax rate to the stated percentages.[7] However, the deductions are keyed off the tax rates applicable to domestic corporations.[8] As a result, and because individual rates are higher than corporate rates, the maximum "equivalent percentage" rates for individuals, estates and trusts are 9.05% and 17.5% for calendar year taxpayers and 14.05% and 27% for fiscal year taxpayers. If a U.S. taxpayer expatriates, the person must pay a tax equal to 35% of the section 965(c) deduction.[9]

[1] IRC §965(e).
[2] IRC §951(b).
[3] IRC §965(b).
[4] The reduced rate is not applicable to taxes imposed by §§4940 or 1411. Treas. Reg. §1.965-3(f)(3) and (4).
[5] IRC§965(c)(1)(A).
[6] IRC§965(c)(1)(B).
[7] IRC §965(c). The deduction is not an itemized deduction. Treas. Reg. §1.965-3(f)(1).
[8] IRC §965(c)(2)(A). The deduction is based on the highest rate of tax imposed under section 11.
[9] Treas. Reg. §1.965-3(d)(2).

A deemed paid foreign tax credit offsets the transition tax for corporate U.S. Shareholders of a specified foreign corporation and individual U.S. Shareholders of a CFC who make an election under §962 to be taxed at corporate rates.[10] However, the credit for foreign taxes associated with the earnings subject to the transition tax are reduced to take into account the deduction allowed by §965(c). The amount disallowed is 77.1% of the foreign taxes on earnings subject to tax at an 8% rate and 55.7.1% of the foreign taxes on the earnings subject to tax at 15.5% rate.[11]

U.S. Shareholders may elect to defer payment of the transition tax, without interest, under sections 965(h) and 965(i), if applicable. Section 965(h) allows any taxpayer to elect to pay the transition tax over 8 years.[12] Section 965(i) allows subchapter S shareholders to defer payment of the transition tax until a triggering event occurs, as discussed below.

Section 965(h) provides that for the first five years, only 8% of the tax is due. In the sixth year, 15% is due, in the seventh year 20% of the tax is due and in the eighth year 25% of the tax is due. No interest is due on the deferred tax. If the transition tax is later increased, the deficiency can be prorated over the unpaid installments, unless the underpayment was due to negligence, intentional disregard of rules and regulations or fraud.[13]

A domestic pass-through owner who is subject to the transition tax, and not the domestic pass-through entity, makes the deferral election.[14] A domestic pass-through entity includes a partnership, S corporation or any other person other than a corporation to the extent that the income or deductions of the person are included in the income of one or more direct or indirect owners or beneficiaries.[15] A domestic trust is subject to income tax on a portion of the section 965(a) amount and its beneficiaries or owners are subject to tax on the remaining portion. The domestic trust is treated as a pass-through entity with respect to the portion of the income on which it is not taxable.[16] Thus, the nongrantor trust can make a deferral election with respect to its share of the transition tax and the beneficiaries may make elections with respect to their shares of the tax.

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[10] IRC §960 allows U.S. Shareholders of CFCs to credit foreign taxes paid by the foreign corporation. The deemed paid credit is allowed only to corporations and individuals who make a §962 election. For SFCs that are not CFCs, domestic corporate shareholders and shareholders who make a §962 election generally would be entitled to a deemed paid credit under §902 because §965 requires inclusion in income for the last taxable year of a SFC beginning before January 1, 2018. IRC §960 was amended by the TCJA effective for tax years beginning after December 31, 2017, to apply only to CFCs, but the tax imposed by §965 was for the prior year, when the deemed paid credit (then allowed by §902) was not so limited.

[11] IRC §965(g).

[12] IRC §965(h); 1.965-7(b)(1). In the case of a domestic pass through entity, the person who is treated as the owner of the entity makes the election, *e.g.* the grantor of a grantor trust. A subchapter S shareholder may elect to defer all of the tax, as discussed below.

[13] IRC §965(h)(4).

[14] Treas. Reg. §1.965-7(b).

[15] Treas. Reg. §1.965-1(f)(28).

[16] Treas. Reg. §1.965-2(f)(28). This regulation provides: "For example, if a domestic trust is subject to federal income tax on a portion of its section 965(a) inclusion amount and its domestic pass-through owners are subject to tax on the remaining portion, the domestic trust is treated as a domestic pass-through entity with respect to such remaining portion."

II. Acceleration Events under Section 965(h)

A. Principles and purposes

The tax deferred by a section 965(h) election may be due sooner if an acceleration event occurs. The tax is due on the date of the acceleration event.[17]

Under applicable regulations, acceleration events include:[18]

a. Failure to timely pay an installment;

b. Liquidation, sale, exchange, or other disposition of substantially all of the assets of the person making the installment election, including bankruptcy or death (in the case of an individual);

c. In the case of a person who is not an individual, cessation of business by the person;

d. Any event that results in the person no longer being a U.S. person;

e. Change in membership of a consolidated group; and

f. A determination by the IRS that there was a material misstatement or omission in a transfer agreement.

The regulations provide that the death of the person who is liable for the transition tax is an acceleration event and requires immediate payment of any tax deferred under a section 965(h) election.[19] In some cases (which are referred to in the regulations as covered acceleration events), but not in the case of death, which is not a covered acceleration event, an acceleration event will not accelerate the time for payment of tax, if within 30 days of the acceleration event, a transfer agreement is signed and filed by an eligible transferee.[20] Section 9100 relief is not available for late filed agreements.[21] An eligible transferee must agree to assume the deferred tax liability (although the transferor, if the transferor continues to exist, remains jointly and severally liable for the tax) and represent that the eligible transferee is able to pay tax.[22] An eligible transferee is "a **single**

[17] Code §965(h)(3); Treas. Reg. §1.965-7(b)(3)(i).
[18] Treas. Reg. §1.965-7(b)(3)(ii).
[19] Treas. Reg. §1.965-7(b)(3)(iii)(A)(1)(*ii*). Death is not a covered acceleration event and therefore is not eligible for a continuation of installment payments if the parties file a transfer agreement.
[20] In the case of acceleration events occurring on or before February 5, 2019, the date of publication of final regulations under §965, a transfer agreement must have been filed by March 7, 2019, in order to maintain deferral.
[21] Treas. Reg. §1.965-7(b)(iii) (B)(2).
[22] Treas. Reg. §1.965-7(b)(3)(iii)(B)(*4*)(*ii*) and (*vii)*.

United States person that is **not a domestic pass-through entity… that acquires substantially all of the assets of an eligible section 965(h) transferor.”**[23]

A taxpayer’s transfer of shares of the SFC is not necessarily an acceleration event; an acceleration event is a disposition of substantially all of the assets of the taxpayer who owes the transition tax. Therefore, a transfer of shares of a SFC by an individual shareholder to a subchapter C corporation would not be an acceleration event if the shares did not represent substantially all of the assets of the individual. On the other hand, a transfer by a nongrantor trust to a subchapter C corporation of substantially all of its assets would be an acceleration event. However, a subchapter C corporation is an eligible transferee, so that the acceleration event is a covered acceleration event and a transfer agreement may be filed to prevent acceleration of the tax. A transfer of all of the assets of a nongrantor trust to a pass-through entity, such as another trust, a subchapter S corporation or a partnership, would be an acceleration event. Because the transferee is a pass-through entity, it is not an eligible transferee and therefore cannot file a transfer agreement and continued deferral is not possible. A transfer from a grantor trust to a non-grantor trust would not be an acceleration event unless the transfer represented substantially all the assets of the grantor (the taxpayer) even if the transfer represents all of the assets of the grantor trust.

The regulations do not expressly address whether a transfer of assets that does not change the tax ownership of such assets, such as a transfer by a grantor of substantially all her assets to a revocable trust created to avoid probate, is an acceleration event under section 965(h)(3). It should not be. Consistent with the government’s position that a grantor is deemed to own the assets of a grantor trust, there has been no transfer.[24] However, it is disturbing that the regulations under section 965(i) specify that a transfer of subchapter S stock by a taxpayer that does not change tax ownership is not a triggering event (discussed below) that accelerates the due date for payment of the transition tax.[25] The absence of similar language in the section 965(h) regulations may create an adverse inference. If the purpose of the acceleration rules is to protect the government’s ability to collect tax, a transfer to a revocable trust should be ignored not because it doesn’t change tax ownership but because the trust remains subject to the rights of the grantor’s creditors. A transfer of substantially all the grantor’s assets to an irrevocable grantor trust (admittedly an unlikely event) should not be ignored if it cuts off creditor’s claims. That is, tax ownership does not appear to be correlated with collectability. For example, if collectability is the focus of the regulations, a subchapter S election by a C corporation would change the identity of the taxpayer but would not impair the ability to collect tax from the corporation and therefore should not be an acceleration event. If the S election is an acceleration event, because the resulting entity is a domestic pass-through entity, a transfer agreement would not be available to defer tax.

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[23] Treas. Reg. 1.965-7(b)(3)(iii)(B).
[24] Rev. Rul. 85-13, 1985-1 CB 184.
[25] Treas. Reg. §1.965-7(c)(3)(ii)(C). There is no similar provision addressing a transfer for purposes of §965(h).

According to the preamble to the regulations, nonrecognition events may be acceleration events, such as transferring assets in a section 351 or section 721 exchange, inbound F reorganizations, and liquidations of foreign subsidiaries.[26] The regulations do not clarify whether decanting, reformation, modification, merger, severance, or material modification of trusts (which are also typically nonrecognition events) are acceleration events. If they are acceleration events, and if the transferee is a domestic pass-through entity, the transfer would not be a covered acceleration event and tax would be due immediately.

The regulations adopt more restrictive rules than the statute. The statute provides the following regarding acceleration:

> If there is an addition to tax for failure to timely pay any installment required under this subsection, a liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), a cessation of business by the taxpayer, or any similar circumstance, then the unpaid portion of all remaining installments shall be due on the date of such event (or in the case of a title 11 or similar a case, the day before the petition is filed). The preceding sentence shall not apply to the sale of substantially all the assets of a taxpayer to a buyer if such buyer enters into an agreement with the Secretary under which such buyer is liable for the remaining installments due under this subsection in the same manner as if the buyer were the taxpayer.[27]

Nothing in the statute addresses the consequences of the death of a taxpayer. The only justification for treating death as an acceleration event is that death is a "similar circumstance" to a sale of substantially all the assets of the taxpayer. To the contrary, death has never been treated as a sale of assets under any other provision of the Code. Instead, section 691 treats the estate or other successor in interest as assuming the tax incidents of a decedent.

The preamble explains the treatment of the taxpayer's death under the regulations as follows:

> The death of an individual taxpayer is similar to any transfer or other disposition of substantially all of the assets of a taxpayer, and, accordingly, is a similar circumstance that should be an acceleration event. The Treasury Department and the IRS have determined that there are administrative difficulties with transferring liabilities and executing transfer agreements in the event of death. Moreover, in many cases, there would be multiple beneficiaries in the case of death, and multiple transferees are not permitted for purposes of section 965(h).

[26] T.D. 9843, Regulations Regarding the Transition Tax Under Section 965 and Related Provisions, 84 Fed. Reg. (2/5/19), Preamble at VII. B. 1.
[27] IRC §965(h)(3).

The statute does not prohibit multiple transferees. The preamble summarily explains the prohibition on multiple transferees for purposes of acceleration events as follows: "[T]he existence of multiple transferees poses significant administrative challenges for the IRS." This is curious because multiple transferees are allowed in the case of a section 965(i) election. It is not apparent why the administrative challenges are any different in the case of a section 965(h) election.

A. Death should not be an acceleration event and if it is, it should be a covered acceleration event.

There is no reason why death should accelerate the payment of tax deferred under section 965(h). Death does not eliminate the right of creditors to collect the decedent's debts. A decedent's estate would always be liable for the donor's debts, including deferred tax.[28] An executor or trustee is personally liable if she distributes assets of a decedent's estate or a trust and the estate or trust has insufficient assets to pay tax owed by the estate or trust.[29] Congress did not allow concerns about impairing collectability to prevent enactment of the Garn-St. Germain Depository Institutions Act[30] that preempts state law and prohibits mortgage lenders from enforcing a due-on-sale clause on the death of the mortgagor when the mortgaged assets pass to the decedent's family.

The death of a taxpayer should not impair collection of the tax even if there are multiple transferees. Taxes may be collected from a transferee who would be liable for a transferor's debts if the transfer leaves the transferor unable to pay her debts under the fraudulent conveyance laws of all states.[31]

Even if multiple transferees are not allowed, death should not be an acceleration event, particularly if substantially all the decedent's assets pass to her estate or revocable trust, as is typical. The fact that the settlement of the estate or trust may require the transfer assets to multiple transferees should allow the deferral of acceleration at least to the date when such transfers are made by the executor or trustee, as is the case under the deferral election under section 965(i). Postponing the acceleration event to the time of transfer from the decedent's estate to its beneficiaries would be helpful because the estate would have some control over the timing of this event.

While it is reasonable for ease of administration of the tax law to require that a transferee sign a transfer agreement even if it only affirms what the laws require even without an agreement, it is not reasonable to require that the agreement be signed and filed within 30 days (a requirement that is particularly difficult to satisfy in the case of a taxpayer's death), prohibit an extension of time to file for reasonable cause or disallow transfer agreements.

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[28] IRC §6901.
[29] 37 U.S.C. §3713.
[30] PL 97-320 (10/15/1982), 12 U.S. C. §1701J-3
[31] IRC §6901.

Making the accelerated tax due *on the date of death* creates an impossible task because an executor or administrator would not be appointed until later, so that in most cases there would be no person legally authorized to make a tax payment on the date the taxpayer died. Even if there were such a person, such as the trustee of a revocable trust, the trustee would likely have other concerns on her mind on the day of the grantor's death.

The treatment of transfers at death is different under section 965(h) from sections 965(i), 691 and 1400Z. Each of these three statutes addresses the transfer of an interest in property associated with income – S corporation stock in the case of section 965(i), transfer of an item of income in respect of a decedent in the case of §691 and equity in a qualified opportunity zone investment in the case of section 1400Z. By contrast, an acceleration event for purposes of section 965(h) is an event similar to a sale of *substantially all the assets of the taxpayer* rather than a transfer of shares of stock or an equity interest. Notwithstanding this statutory difference defining an event that potentially accelerates the time for payment of tax, the treatment of transfers at death under the section 965(h) regulations is not reasonable.

None of sections 965(i), 691 and 1400Z accelerate the time for payment of tax at death. Section 965(i) does require that a transfer agreement be filed to avoid acceleration of the tax payment due date, but the transfer agreement is not due to be filed until the due date for the decedent's final income tax return. The death of an investor in a qualified opportunity zone is not an inclusion event that accelerates tax.[32] Income that accrued to a deceased taxpayer but was not due before death ("income in respect of a decedent") is not immediately taxed at death but is due and payable by the decedent's estate, heir or legatee when received.[33]

B. Transfers to revocable trusts and other entities that are liable for the transferor's debts should not be acceleration events.

Gifts would not be acceleration events unless a person gifted substantially all her assets, which would be unusual. However, it would not be unusual for a taxpayer to transfer all her assets to a revocable trust designed to avoid probate. Such transfers should be disregarded, not because the grantor remains the owner of the revocable trust for income tax purposes under the grantor trust rules, but because the trust assets are subject to the claims of the grantor's creditors. A rule exempting transfers to a revocable trust would *not* be the same as the rule for triggering events under section 965(i) or inclusion events under section 1400Z, which disregard transfers if the transfer does not change tax ownership. For example, a transfer to an irrevocable trust that is not subject to the claims of the grantor's creditors but is still a "grantor trust" should be an acceleration event in the unlikely event that the grantor transfers substantially all her assets. Although the regulations implementing

[32] Treas. Reg. §1.1400Z2(b)-1(c)(4). Applicable proposed regulations provide an exception to "inclusion events" for transfers at death to a deceased owner's estate or joint owner or any subsequent transfers made "by operation of law."

[33] Treas. Reg. §1.691(a)-4. However, a transfer of a decedent's assets by the estate, heir or legatee that is not required by operation of law would accelerate tax under §691. The same rule is followed for purposes of section 1400Z. Treas. Reg. §1.1400Z2(b)-1(c)(4).

section 965(h) are not clear, it appears that tax ownership is not relevant to acceleration events for tax deferred under section 965(h). The regulations should be clarified to explain whether a transfer occurs based on tax ownership or property ownership under state law.

C. Death of a spouse or transfers to spouse who filed joint income tax returns in the transition year

There is no exception to acceleration upon the death of a taxpayer who filed a joint return with her spouse even if substantially all of the taxpayers' assets pass to the spouse. Both spouses are jointly and severally liable for the deferred tax if a joint return was filed, but the regulations make no exception for this circumstance. If "substantially all" is defining both taxpayers combined assets rather than the assets of each of the taxpayers, then the death of one of them should not accelerate the tax payment obligation unless the deceased taxpayer owned substantially all the assets of both taxpayers.

A gift or bequest to a spouse who filed a joint tax return with the taxpayer should not be an acceleration event even if the taxpayer transfers substantially all her assets to her spouse because the spouse is jointly and severally liable for the deferred tax on the joint return. Such a transfer not only does not impair collection but makes collection more likely.

D. Domestic pass-through entities should be eligible transferees

Section 965 allows the owners of a domestic pass-through entity to make the section 965(h) election in the first place but not to sign a transfer agreement. A trust, which is a domestic pass-through entity to the extent its income flows through to beneficiaries as a result of a distribution deduction, is allowed to make the section 965(h) election for the portion of the trust income on which it is taxable (undistributed income) and the beneficiaries are allowed to make the election as to the portion on which the beneficiaries are taxable (distributed income). However, under the regulations, if a transfer to a trust would accelerate the tax, no transfer agreement could be signed to allow continued deferral because the trust is a pass-through entity.

There would be no jeopardy to the government's ability to collect the tax due after the transfer if the regulations were modified to allow a pass-through entity and its owners to sign transfer agreements. In the transition year when deferral is elected, the tax allocable to the pass-through entity and each of its owners is known. The allocation of liability for the deferred tax among a transferee pass-through entity and its owners is not clear, but this should not be an issue if the pass-through entity and its owners agree to assume joint and several liability for the deferred tax. If a trustee were permitted to sign on behalf of a trust and an executor to sign on behalf of an estate, an executor or trustee would not make distributions to beneficiaries to prevent collection of the tax, because that would expose the executor or trustee to personal liability for making distributions before satisfying taxes due.[34]

[34] 37 U.S.C. 3713.

A rule disallowing a transfer agreement is not practical. Transfers from trusts to other trusts are common and sometimes unavoidable. For example, upon the death of a beneficiary, typically a trust would be divided into separate trusts for each succeeding beneficiary (e.g. children of the initial beneficiary). In this case, the regulations would require immediate payment of the tax. Not only are the transferees pass-through entities, but the trust would be divided so that there would not be a single transferee. Each feature is a disqualifying event. Again, section 965(i) allows multiple transferees and there is no reason why transfers to multiple transferees should mandate acceleration under section 965(h).

There are a number of other common occurrences that could potentially accelerate the tax, such as a decanting, a reformation, a material modification, a merger, a severance or a conversion of a nongrantor trust into a grantor trust or vice versa. Unless there is only a single transferee and the transferee is considered to be either the same trust or a single non-pass-through owner, a transfer to a pass-through entity would require immediate payment of the tax deferred under section 965(h). No one could plausibly argue that a reformation, modification, merger or conversion impairs the collectability of the deferred tax, but, under the regulations, no transfer agreement would be possible. A severance would divide the liability among the severed trusts and increase the number of taxpayers from whom the tax is collectible, but this is not different from allowing multiple transferees to sign transfer agreements in the case of triggering events accelerating tax due under a section 965(i) election, discussed below.

III. Triggering Events for Subchapter S Shareholders Making Section 965(i) Elections

In the case of a shareholder of a subchapter S corporation that is a U.S. Shareholder of a specified foreign corporation, all of the transition tax can be deferred in full until a triggering event occurs.[35] The treatment of triggering events is much more taxpayer friendly than the treatment of acceleration events. We describe how these rules differ from those applicable under section 965(h).

Triggering events include:

1. The U.S. Shareholder ceasing to be an S corporation;
2. The liquidation, sale, exchange or other disposition of substantially all of the assets of the S corporation, including bankruptcy, a cessation of the business of the S corporation;
3. A transfer of any shares of the S corporation (including by reason of death or otherwise) that results in a change of ownership for federal income tax purposes; and
4. The IRS determines that there has been a material misrepresentation or omission in a transfer agreement.

[35] IRC §965(i).

If an S corporation shareholder transfers less than all her shares, the transfer will be a triggering event only with respect to the portion of shares transferred.[36] In addition, as long as there is only one transferee as to each portion of the shares transferred, there can be multiple transferees in the case of a section 965(i) election. Separate transfer agreements are signed for each portion.

If a triggering event occurs, deferral may continue if: (i) the triggering event is a covered triggering event, (ii) there is an eligible transferor and an eligible transferee[37] and (iii) a transfer agreement is timely filed.[38] As in the case of a section 965(h) election, death is a triggering event for purposes of the section 965(i) election, but unlike the section 965(h) election, death is a "covered" triggering event for purposes of section 965(i) so that continued deferral of the payment of tax is possible.[39] In the case of a triggering event due to death, a transfer agreement is due to be filed on the due date (determined without extensions) for the decedent's final income tax return. In other cases, the due date for the transfer agreement is 30 days after the date of the triggering event. The transfer agreement must be signed by an eligible transferee. In the case of death, the executor of the decedent's estate is the eligible transferee unless the identities of the beneficiaries (other than a domestic pass through entity) who are entitled to receive the shares of the S corporation are known as of the due date for filing the transfer agreement, in which case the beneficiaries are the eligible transferees.

In the case of a qualifying subchapter S trust (a QSST) or a grantor trust, the eligible transferee is the person who is treated as the owner of the stock. In the case of a testamentary trust or a trust that makes a §645 election, the eligible transferee is the executor of the estate.[40] If an executor is the eligible transferee, a second triggering event occurs when the estate transfers shares of the S corporation to the beneficiaries and the executor and the beneficiaries then must sign and file the transfer agreement within 30 days of the transfer of shares. The transferor and the transferee and the S corporation are all jointly and severally liable for the unpaid transition tax.[41] This joint and several liability could create a problem for the prompt termination of a decedent's estate because it could expose the executor to personal liability.[42] As is the case with a section 965(h) election, the transfer agreement must contain a representation that the transferee is able to pay the transition tax and if the debt leverage ratio of the transferee exceeds 3 to 1, the IRS may not allow continued deferral of the tax.

[36] Treas. Reg. §1.965-7(c)(3)(iii).
[37] An eligible transferee is a single U.S. person other than a domestic pass-through entity. Treas. Reg. §1.965-7(c)(3)(iv) provided that eligible transferee includes a person treated as the owner of the subchapter S shares under Treas. Reg. §1.1362-6(b)(2). In the case of multiple partial transfers, a separate transfer is deemed made to each transferee and a separate transfer agreement is signed for each.
[38] Treas. Reg. §1.965-7(c)(3)(iv).
[39] Treas. Reg. §1.965-7(c)(3)(iv): A covered triggering event includes a transfer of shares including by reason of death or otherwise that results in a change of ownership for federal income tax purposes.
[40] Treas. Reg. §1.965-7(c)(3)(iv).
[41] Treas. Reg. §1.965-7(c)(3)(iv)(D)(2); -7(c)(4).
[42] 37 U.S.C. §3713.

Following a triggering event, payment of all the transition tax may continue to be deferred if a transfer agreement is signed. If a transfer agreement is not available or is not timely signed and filed, the transferee can elect to pay the tax in installments over 8 years as described above.[43] For this reason, the problems created by Treas. Reg. §1.965-7(b)(3) will not become obsolete when section 965(h) elections made in the transition year expire. New section 965(h) elections may be made in later years.

We have only two concerns about the regulations governing triggering events under section 965(i), the issue of a decedent's estate's continuing liability for the deferred tax and the time for filing transfer agreements. An executor of a decedent's estate or trustee of a decedent's revocable trust may need a release from liability before winding up the estate or trust. The regulations should permit the IRS to issue a release for the fiduciary where the liability has been assumed by the transferee. There is no reason not to allow extensions of time to file transfer agreements where the taxpayer can show reasonable cause for a late filing.

IV. Our Recommendations

For the reasons explained above, we recommend the following changes to applicable regulations:

1. Provide that (i) the death of a taxpayer is not an acceleration event, (ii) in the alternative, if death is an acceleration event it is a covered acceleration event without regard to the number of transferees, or (iii) if neither (i) or (ii) is accepted, that one or more of the following exceptions apply:

    a. If the taxpayer filed jointly with her spouse in the transition year and the taxpayer either (i) bequeaths substantially all of her estate to the surviving spouse who is jointly and severally liable for the tax or (ii) the survivor owns substantially all the assets of both such joint owners, there is no acceleration event;

    b. If substantially all the decedent's assets pass to his or her estate or revocable trust and the executor or trustee signs and files a transfer agreement, acceleration is deferred until the estate is distributed to the beneficiaries; and/or

    c. If substantially all the decedent's assets pass to a single beneficiary (including a trust), acceleration is deferred if the single beneficiary signs and files a transfer agreement.

2. Allow a transfer agreement to be signed in the case of death, on the due date for the decedent's final return.

[43] Treas. Reg. §1.965-7(c)(3)(v).

3. Allow extensions of time to file transfer agreements upon showing of reasonable cause.

4. Provide that a transfer to a revocable trust or other disregarded entity that is liable for the taxpayer's debts is not an acceleration event but that other transfers that do not change "tax ownership" may be acceleration events if the transferee is not liable for the transferor's debts.

5. Provide that a domestic pass-through entity is an "eligible transferee" and continued deferral is available if both the entity and the owners of the entity sign transfer agreements to assure collection from the transferees.

6. Allow multiple transferees to sign transfer agreements.

7. Allow an executor or trustee to apply for a release of liability.