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Steve Leimberg's Business Entities Email Newsletter - Archive Message #321

Date: **04-Feb-26**

From: **Steve Leimberg's Business Entities Newsletter**

Subject: **Jonathan Blattmachr, Thomas Tietz & Martin M. Shenkman on Code §2036(b) Voting Stock: A Technical Summary for Practitioners**

"The ability to vote stock of a closely held corporation can cause estate inclusion, undermining estate planning goals. Practitioners should pay close attention to these issues as inappropriate language in corporate governing documentation or trust instruments could create an unintended problem. For closely held voting stock, treat any retained voting authority by the transferor, whether direct (contractual "must-vote" covenants) or indirect (trustee/advisor powers), as presumptively includible potentially causing estate tax inclusion under §2036(b) and consider planning to avoid 2036(b) or to address directly the issues that might cause such inclusion."

Jonathan Blattmachr, **Thomas Tietz** and **Martin Shenkman** provide members with a technical summary of Section 2036(b)'s special estate-inclusion rule for corporate voting stock.

Jonathan Blattmachr is a Principal in **ILS Management, LLC** and a retired member of Milbank Tweed Hadley & McCloy LLP in New York, NY and of the Alaska, California and New York Bars. He is recognized as one of the most creative trusts and estates lawyers in the country and is listed in The Best Lawyers in America. He has written and lectured extensively on estate and trust taxation and charitable giving.

Martin M. Shenkman is an attorney in private practice in New Jersey and New York who concentrates on estate planning. He is the author of over 40 books and more than 1,400 articles and has won many professional awards.

Thomas Tietz, JD, has lectured at the Notre Dame Tax & Estate Planning Institute and for the New Jersey Bar and Institute of Continuing Legal Education. He has published articles in the American Bar Association E-Report, Wealthmanagement.com and Trusts & Estate Magazine. He is a member of the American Bar Association, Real Property, Trust and Estate Law and Business Law sections, the New York State Bar Association.

Here is their commentary:

COMMENT:

Introduction and Background

Historically, much of estate planning has involved avoiding assets transferred prior to death, typically by lifetime gift, being included in a decedent's gross estate as that inclusion could result in estate tax being imposed on them. Several provisions of the Internal Revenue Code are designed to thwart attempts to avoid estate tax inclusion of assets transferred prior to death.

One of the primary sections which tries to cause estate tax inclusion of assets transferred before death is Section 2036. It causes inclusion if the transferor retained for life (or any period not ascertainable without referring to the transferor's death or which in fact does not end before his or her death):

"(1) the possession of enjoyment of, or the right to the income of the transferred property, or (2) the right, either alone or in conjunction with any other person, to designate the person who shall possess or enjoy the property or the income therefrom."[i]

Over time, disputes arose as to whether and how the Section applies.[ii] It is difficult to draw complete conclusions. For example, although the Supreme Court in Byrum[iii], held that the closely held stock the decedent had placed in trust before death was not included in his gross estate despite his de facto control over the dividend policy of the corporation, some facts, such as the absence of a third-party minority shareholder, may make inclusion occur. This is especially difficult because Congress passed legislation[iv] to overrule at least part of Byrum. Indeed, the original Congressional attempt at such overruling was substantially revised. Hence, it is difficult to draw "hard and fast" conclusions as to how Section 2036(b) does or does not apply. In fact, although the section was enacted nearly 50 years ago, no regulations under it have been issued. Nonetheless, the goal of this article is to provide some practical guidelines for practitioners to consider in determining if Section 2036(b) applies to a client's planning, and steps the client may consider taking to endeavor to reduce the risk of it applying.

2036 Rules and Overview

Code Section §2036(b) provides a special estate-inclusion rule for corporate voting stock: if a transferor retains the right to vote (directly or indirectly) any shares of a controlled corporation after making a lifetime transfer of such shares, the transferred shares are included in the transferor's gross estate at death. A corporation is "controlled" if, "…at any time after the transfer of the property and during the 3-year period ending on the date of the decedent's death, the decedent owned (with the application of section 318), or had the right (either alone or in conjunction with any person) to vote, stock possessing at least 20 percent of the total combined voting power of all classes of stock."[v] This is a lower bar than corporate control and frequently met in family corporations.

In practice, a shareholders' agreement that obligates the transferor to continue voting transferred shares (for example, following an intra-family transfer to a trust for the transferor's spouse) is treated as a retained voting right, and the transferred shares remain includible in the transferor's estate under §2036(b). This is so even where the transferor's record ownership is below a control threshold, because the test asks whether the transferor owned or had the right to vote at least 20% during the relevant period. For example, if the client owns 10% of the shares of a corporation, but retains the right to vote another 15% of the shares held in a trust client previously transferred, that would exceed the 20% threshold and cause inclusion under Code Section 2036(b).

Legislative Backdrop and Interaction With §2035

Section 2036(b) was enacted to reverse the Supreme Court's holding in *United States v. Byrum*, which had concluded that retained voting rights in that case did not constitute a retained enjoyment. Congress responded to the Byrum case in the Tax Reform Act of 1976[vi] by enacting legislation that provided that retained voting rights may cause estate inclusion. Separately, Code Section §2035[vii] treats certain relinquishments within three years of death as includible transfers. Thus, relinquishing voting rights within three years of death is treated as a transfer that may still produce inclusion at death.

Estate Tax Inclusion Period (ETIP) and GST Implications

Because retained voting rights are a form of retained interest that causes estate inclusion, any gift involving such rights triggers an Estate Tax Inclusion Period (ETIP). During an ETIP, GST exemption cannot be allocated to the subject property. The ETIP generally ends only when the property is no longer includible in the transferor's estate—typically when the retained voting rights expire or are fully relinquished (and not within three years of death).

What Constitutes a "Retained Right to Vote"

- Direct voting rights or obligations on transferred shares (e.g., a shareholders' agreement requiring the transferor to vote the shares after gifting) are treated as a retained right to vote, causing estate inclusion.
- Indirect voting powers held through fiduciary offices (e.g., serving as trustee of a trust that holds the voting shares) can function as retained voting rights if the

trustee (or “investment trustee/advisor”) has authority to vote or to direct voting of the shares.

- The control threshold is met if at any time after transfer and within three years before death the transferor owned, or had the right to vote 20% or more of the combined voting power. Consider that the statute’s emphasis is on the “right to vote,” not just the record ownership of the shares. Aggregation with a spouse is not automatically applied. The analysis may focus on the transferor’s own ownership or voting rights, including rights to vote shares previously gifted, but still voted by the transferor under the corporation’s governing agreements.

Drafting and Transaction Red Flags Observed

- Shareholders’ agreement obligations that follow the shares can continue a retained voting right. For example, a transferee trust could be bound by the terms that effectively require the transferor, now in a fiduciary role, to vote the trust’s shares (or control the vote). This may include if the settlor transfers shares to a trust for which he serves as the investment trustee, and in that capacity, votes shares subject to the same shareholders’ agreement.
- Certain conversion features may mitigate voting exposure. For example, common stock may convert to non-voting upon the occurrence of certain events, such as termination of employment. However, if the transferor retains any present voting authority prior to the conversion event, or through other mechanisms such as trust powers, or board of director appointment rights, the estate inclusion exposure persists until the voting power ceases and the death occurs more than three years later.
- Improperly drafted trust provisions that permit a transferor-trustee to vote “in a conflict” can also create voting authority. Thus, coordination of trustee powers with §2036(b) constraints is essential.

Suggested Drafting Language to Potentially Avoid §2036(b) Inclusion

Practitioners might consider incorporating trust provisions that prohibit any fiduciary (investment trustee, investment advisor) from voting shares of a §2036(b) controlled corporation in any manner that could result in estate inclusion. This restriction could apply notwithstanding any other trust language. Also, consider naming a person to vote stock that the fiduciary involved may be prohibited from voting. Practitioners should also advise clients to carry out these rules in practice. If a named person is prohibited by the governing instrument from voting stock, but nonetheless their signature appears on agreements memorializing shareholder votes, that would contradict the terms of the trust and leave the same issue.

Here is sample language courtesy of Interactive Legal Systems (“ILS”): *“…provided, however, if the Grantor or any other donor is serving as Investment Trustee hereunder, then the Grantor or such other donor shall not have the power to vote any direct or indirect interest in any stock that would, by reason of such voting power, be included in* *the Grantor's or such other donor's gross estate for Federal estate tax purposes under Code Sec 2036(b). With respect to any such "2036(b)" stock described in the immediately preceding sentence, the Trustee (other than an Interested Trustee) shall appoint another individual, who is not a person in whose estate such stock would be so included if such person held the power, directly or indirectly, to vote such stock, and which person is not related or subservient to the Grantor or the Grantor's Spouse*…" Alternatively, practitioners may specifically name a person and leave the right to appoint someone to vote 2036(b) stock as a backup to that.

Planning Checklist for §2036(b) Compliance

- Evaluate voting considerations and constraints for any corporate shares moved into a trust. Confirm whether the client, or the client's spouse, will have direct or indirect voting powers (as trustee, investment trustee, trust protector, investment advisor, board of director appointment rights, or under shareholder's agreements' covenants). If any such power exists, assume §2036(b) inclusion absent a valid carve-out or removal of the power and consider remedial action.

- Test control of voting rights. Determine whether at any time after the transfer and during the three years preceding death the transferor, whether the transferor owned or had the right to vote 20% or more of the combined voting power. If yes, the corporation is controlled for purposes of §2036(b).

- Endeavor to eliminate the transferor's voting rights. Revise the shareholders' agreement, and trust instruments, so that neither the client/transferor, nor the client's spouse, retains any present right to vote transferred shares (including indirect authority). Consider appointing an independent trustee to hold and vote shares and ensure no retained direction or veto power by the transferor.

- Beware of covenants in a shareholders' agreement or other governing documents that require the transferor to vote shares. Avoid shareholder provisions that require the original transferor to continue voting gifted shares. These types of provisions are a per se trigger for §2036(b) inclusion.

- Coordinate "non-voting" strategies: where possible, convert voting shares to non-voting or recapitalize to reduce exposure, but verify that no other instrument gives the transferor voting influence (e.g., trustee powers, side letters).

- Consider §2035: if voting rights are relinquished within three years of death, inclusion may still occur under §2035. Plan relinquishment of voting rights if feasible to be outside the three-year time frame or restructure the voting arrangements so that the transferor never retains such rights post-transfer.

Conclusion

The ability to vote stock *of* a closely held corporation can cause estate inclusion, undermining estate planning goals. Practitioners should pay close attention to these issues as inappropriate language in corporate governing documentation or trust instruments could create an unintended problem. For closely held voting stock, treat any retained voting authority by the transferor, whether direct (contractual "must-vote" covenants) or indirect (trustee/advisor powers), as presumptively includible potentially causing estate tax inclusion under §2036(b) and consider planning to avoid 2036(b) or to address directly the issues that might cause such inclusion.

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

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[i] See IRS Code Section 2036, a copy of which is accessible at https://www.law.cornell.edu/uscode/text/26/2036, last accessed January 6, 2026.

[ii] See, generally, Hellwig, *Revisiting Byrum*, 23 Va. Tax Rev. 275 (2003).

[iii] United States v. Byrum, 408 US 125 (1972).

[iv] Code Section 2036(b).

[v] Code Section 2036(b)(2).

[vi] H.R. 10612- Tax Reform Act of 1976, accessible at https://www.congress.gov/bill/94th-congress/house-bill/10612, last accessed January 6, 2026.

[vii] Text of Code Section 2035 accessible at https://www.law.cornell.edu/uscode/text/26/2035, last accessed January 6, 2026.