January, 2023

Selected 2023 Heckerling Topics

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Heckerling – January, 2023

Agenda – Recent Developments

- 2023 Inflation Adjustments
- 2022-2023 Priority Guidance Plan
- New Mortality Tables – Proposed Regulations
- Rev. Proc. 2022-32 – Portability
- Section 2053 Estate Tax Proposed Regulations
- Corporate Transparency Act
- Substantiation of Charitable Gifts
- Estate of DeMuth – Uncashed Gifts at Death
- Estate of Mellon – Valuation of Cryptocurrency
- CCA 202238014 – IRS Changes Policy on Sprinkling CRUT
- PLR 202206008 – Use of General Power of Appointment to Increase Basis
- Dematteo v. Commissioner – Gift Tax Value of Life Insurance Policy
- Estate of Levine – Intergenerational Split Dollar Life Insurance
- Conservation Easements – Validity of Regulations
- Administrative Procedure Act – Validity of IRS Notices

Agenda – Recent Developments

- SECURE 1.0 – Proposed Regulations
- Notice 2022-53 - SECURE 1.0
- Anti-Clawback Proposed Regulations
- Buck v. U.S. – Undivided Gift of Real Estate Valued Separately
- Baty v. Commisstioner – GRAT Valuation Pending Merger
- Donoghue v. Smith – Swap Transaction with GRAT and Section16(b) of 1934 SEA
- Sorensen v. Commissioner – Wandry Gift Tax Case Settled
- U.S. v Parks – Special Use Valuation on Late Filed Return Allowed
- U.S. v. Allison – Trustee Personally Liable for Estate Tax
- Sander v. Commissioner – Trustee Lack Authority to Act for Decedent – Income Tax
- PLR 202215015 – Grandfathering of GST Allocated Exemption
- Rev. Proc. 2022-19 – Relief for S Corporation Disqualification
- SECURE 2.0

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Agenda – Sessions

- Marital Deduction – Fundamentals
- Planning for the Middle Rich
- Choosing the Right Situs for a Trust
- How to Terminate Representation of a Client
- Installment Sales
- Getting Rid of a Trustee
- Special Needs and Elder Law
- Anti- Money Laundering
- Meet the New Trust – Same as the Old Trust
- Charitable Gifts with Strings Attached
- Ethics and Privileges Landmines with Gifts and Form 709
- Retirement Plan Benefits Payable to Trusts – Who Counts

Recent Developments

2023 Inflation Adjustments

Rev. Proc. 2022-38

- Basic exclusion amount - $12,920,000
- Annual exclusion - $17, 000
- Annual exclusion for gifts to a non-U.S. citizen spouse - $175,000
- Aggregate decrease in value of qualified real property resulting from special use valuation under §2032A - $1,310,000
- Dollar amount used to determine the “2 percent portion” for purposes of calculating interest under §6601(j) of the estate tax deferred under §6166 - $1,750,000

2022-2023 Priority Guidance Plan – November 4, 2022

Income Tax Basis

- Final regulations under §§1014(f) and 6035 regarding basis consistency of property acquired from an estate.
- §1014 basis adjustment at death of owner of a grantor trust if assets are not included in the grantor's taxable estate (new item).
  - Majority view is that there is no step-up in basis when the assets in a grantor trust are not included in the gross estate. The panelists agreed that the issue is not debatable.

2022-2023 Priority Guidance Plan – November 4, 2022

Estate Planning

- Portability – guidance on portability regulations (published in Rev. Proc. 2022-32).
- Gift valuation – valuation of gifts that are includable in the gross estate when the basic exclusion amount at the time of the gift is greater than at the transferor's death under the special rule of Reg. 20.2010-1(c).
- Gift valuation – regulations under Section 7520 for use of actuarial tables to value annuities, life estates, term of years, remainders and reversions.
- Alternate valuation – regulations on restrictions imposed on estate assets during the alternate valuation period (anti-Kohler regulations)
- Deductions – final regulations regarding interest expense and personal guarantees under §2053.

2022-2023 Priority Guidance Plan – November 4, 2022

Estate Planning

- Update to the qualified domestic trust regulations.
- Final regulations under §2801 on taxes on gifts or bequests from certain expatriates.
- Regulations under §2632 on late allocation of generation skipping transfer tax exemption on transfers under §2642(g).
- Definition of a generation skipping transfer tax trust.
- Ordering rules when the amount of generation skipping transfer tax exemption allocated exceeds the transferor's available exemption.
- Final regulations for extension of time to allocate generation skipping transfer tax exemption under §2642(g).

2022-2023 Priority Guidance Plan – November 4, 2022

Miscellaneous

- Final regulations for the changes to retirement plan administration under §401(a)(9) and the SECURE Act.

- Tax-exempt organizations – final regulations for §509(a)(3) supporting organizations and guidance under §4941 regarding private foundations' investments in partnerships with disqualified persons.

- Relief for late regulatory elections – guidance under Reg. 301.9100 for relief for late regulatory elections.

New Mortality Tables – Proposed Regulations

Actuarial Tables - §7520

- Used to annuities, life estates, term of years, remainder and reversionary interests
- New table required to be issued "not less frequently" than every 10 years using "the most recent mortality experience available as of the time of the revision."
- First update to tables occurred in 1989, updated in 1999, updated again in 2009 but not in 2019 due to delays with the 2010 census.
- Updated tables released three years late on May 5, 2022
- The tables will only be available online – they won't be published in the regulations
- The tables will apply to interests valued on or after the first day of the month following the date on which the proposed regulations are finalized. However, for gifts made or decedents dying after 2020 and before the date the regulations are finalized, taxpayers may use either the current or proposed tables for valuation purposes.

New Mortality Tables – Proposed Regulations

New Table Changes

- Longer life expectancy – about 2 years
- Lower value for remainder interest
- Higher value for income interest
- Can rely on current tables of proposed tables after 2020 until effective date of the final regulations but must be consistent.

Rev. Proc. 2022-32 – Portability

Election Extended for Five-Years for Return Below Filing Requirement

- Election deadline originally nine months after death with possibility of six-month extension.
- Rev. Proc. 2017-34 extended the election deadline to two years.
- Rev. Proc. 2022-32 extends the election deadline to the fifth anniversary of the decedent’s death– supersedes Rev. Proc. 2017-34. §9100 relief is available after the 5 year period but a fee and excuse is needed.
- Only applies to estates not otherwise required to file a Federal estate tax return, i.e., “portability only” returns. Also, doesn’t apply if a return has previously been filed and portability was not elected.
- Must include the following language at the top of the Form 706 (in all caps): FILED PURSUANT TO REV. PROC. 2022-32 TO ELECT PORTABILITY UNDER §2010(c)(5)(A)

Section 2053 Estate Tax Proposed Regulations

Background

- The 2009 final regulations generally limit the deduction for claims and expenses to amounts <u>actually paid</u> in satisfaction or settlement of those items, with exceptions for ascertainable amounts, claims against the estate and debt.

- The proposed regulations also address the deductibility of certain types of interest as well as amounts paid under a decedent's personal guarantee.

- The 2009 final regulations expressly reserved for future guidance the issue of applying present-value concepts to determine the deduction amount.

- The June 24, 2022 Section 2053 proposed regulations now deal with these issues.

- The proposed regulations would apply to estates of decedents dying on or after the date the regulations are finalized.

Section 2053 Estate Tax Proposed Regulations

Limitation on Estate Tax Deduction for Administration Expenses, Claims and Interest Expenses

- Proposed regulations cover four items:
  - Apply present value calculations to certain expenses
  - Indicate what interest is deductible
  - When decedent's guarantee is deductible
  - Valuation of claims

Section 2053 Estate Tax Proposed Regulations

Limitation on Estate Tax Deduction for Administration Expenses, Claims and Interest Expenses

- Must present value funeral and administration expenses and certain claims against the estate to be paid in the future, whether contingent or non-contingent
  - Only applies to expenses to be paid more than three years in the future after the decedent's death
  - Use AFR for the month decedent's death occurs, compounded annually. Time between the date of death and payment determines whether short-term, mid-term or long-term rate is used. Must show computations on the return.
- Confirms no deduction allowed for interest on §6166 installment payments
- Deduction allowed for non-§6166 interest on unpaid tax or penalty if actually and necessarily incurred in estate administration.
  - Exception: No deduction if due to executor's negligence, disregard of applicable rules or regulations, or fraud with intent to evade tax

Section 2053 Estate Tax Proposed Regulations

Limitation on Estate Tax Deduction for Administration Expenses, Claims and Interest Expenses

- Interest on loan deductible allowed only if the underlying loan obligation is bona fide and necessary. Must constitute indebtedness under "applicable income tax regulations and general principles of Federal tax law."
  - Includes Graegin loans – illiquidity created intentionally prior to creation of loan obligation to pay estate expenses and liabilities may be denied as not actually and necessarily incurred by the estate. Graegin loans now more risky.
  - Proposed regulations list 11 nonexclusive factors to determine whether loan is bona fide and necessary to estate administration
- Deduction for interest paid based on decedent's personal guarantee must have been bargained for at arm's length, for full and adequate consideration and must be enforceable against the estate, e.g., the decedent was paid a fee for the guarantee.
- A "written appraisal document" by someone qualified (other than certain related parties) to do the appraisal is required to deduct an unpaid claim. Appraisal must be filed with the Form 706

Corporate Transparency Act

Beneficial Owner Reporting Requirements – Effective January 1, 2024

- Enacted on January 1, 2021 as part of the National Defense Authorization Act. Final regulations were issued September 29, 2022.
- Corporations, LLCs and partnerships (reporting entities) must disclose to FInCEN information on "beneficial owners." Reporting entities are those that are created by filing a document with the secretary of state or similar office. Exceptions exist for entities already heavily regulated, e.g., banks, charities.
- Designed to prevent evasion of anti-money laundering rules or hiding illegal activities
- "Beneficial owner" is any individual who directly or indirectly through any contract, arrangement, understanding or relationship exercises substantial control over a "reporting company" or owns or controls at least 25% of the reporting company.
- Reportable information includes legal name, date of birth, residential or business address, identification number (e.g., SSN, passport number)
- Failure to report can result in both civil and criminal penalties

Corporate Transparency Act

Beneficial Owner Reporting Requirements – Effective January 1, 2024

- Entities formed after January 1, 2024 – “company applicants” must report. This would include a paralegal who forms the LLC and the supervising attorney.

- If clients have dormant LLCs, they might consider shutting them down this year to avoid reporting requirements.

- Consider setting up LLCs this year (2023) to avoid the applicant reporting requirement.

Corporate Transparency Act

How it Applies to Trusts or Similar Arrangements

- Currently, private trusts are not included among the entities that must report, and charitable organizations, including private foundations, are specifically exempt from the reporting requirements.
- However, trusts that own 25% or more of a reporting entity may have to report.

Corporate Transparency Act

How it Applies to Trusts or Similar Arrangements – Beneficial Owners

- Trustee or other individual (if any) with the authority to dispose of trust assets;
- Beneficiary who (1) is the sole permissible recipient of income and principal (e.g., a surviving spouse of a marital deduction trust); or (2) has the right to demand a distribution of, or withdraw, substantially all the assets; or
- Grantor who has the right to revoke the trust or otherwise withdraw the assets.
- Note: a trust could have more than one beneficial owner subject to a reporting requirement.

Substantiation of Charitable Gifts

Contemporaneous Written Acknowledgement (CWA) for Gifts of $250 of More

- Albrecht v. Commissioner, T.C. Memo 2022-53 (May 25, 2022) – deduction denied for 120 items donated under five-page deed of gift because the CWA failed to include statement of goods or services provided as required by §170(f)(8).

- Keefer v. U.S., U.S. District Court, Northern District of Texas, Dallas Division, No. 3:20-CV-0836-B (July 6, 2022) – CTA from donor advised fund (DAF) did not include language required by §170(f)(18) that the DAF “has exclusive control over the assets contributed.” A contemporaneous written acknowledgement requires strict, not substantial, compliance. Donor also taxed on gain of sale of the property subject to the donation under the assignment of income doctrine.

- Hickory Equestrian, LLC v. Commissioner, Tax Court (February 8, 2022) – taxpayer’s failure to disclose the donated property’s cost basis on the Form 8283 appraisal summary form results in a loss of a $6.4MM income tax charitable deduction for the gift of a conservation easement.

Substantiation of Charitable Gifts

Contemporaneous Written Acknowledgement (CWA) for Gifts of $250 of More

- Izen v. Commissioner, (5th Cir. June 29, 2022) – income tax charitable deduction denied for donation of an undivided interest in an airplane. Taxpayer failed to obtain a contemporaneous written acknowledgment (CWA) from the charity, in part because it did not indicate whether the charity furnished any goods or services in consideration for the contribution.

- In addition, the taxpayer's social security number was not furnished and there was no written statement from the charity indicating the use (to satisfy the related use rule for gifts of tangible personal property valued at more than $5,000 to a public charity) of the plane.

- Taxpayer's defense of substantial compliance fell on deaf ears as the 5th Circuit said that substantial compliance may apply where the taxpayer acted in good faith and exercised due diligence. However, substantial compliance does apply to satisfy statutory requirements – Congress specifically required the CWA include the include the taxpayer identification number. For the requirement of the taxpayer's identification number see the American Jobs Creation Act of 2004, Pub. L. 108-357, §884, 118 Stat. 1418, 1633-34. See also §170(f)(12)(B)(i).

Checks Unpaid at Death Included in Gross Estate

Estate of Demuth v. Commissioner, T.C. Memo 2022-72 (July 12, 2022)

- Eleven annual exclusion gifts, only one paid before death
- September 6, 2015 - Decedent's son, under a durable power of attorney, writes and delivers eleven annual exclusion gifts
- September 11, 2015 – decedent dies
- September 14-30, 2015 – ten checks paid
- The ten checks written before, but paid after, decedent's death would normally be includable in the decedent's gross estate.
- Treas. Reg. 25.2511-2(b) states that a gift is <u>not</u> complete until "the donor has so parted with dominion and control as to leave in him no power to change its disposition."
- State law (PA) says that mere delivery of a check does not complete the gift because the donor can stop payment on the check until it has been presented for payment.
- In this case, only the value of seven checks were included in the decedent's gross estate because the IRS erroneously stipulated that three checks has been credited by the <u>drawee bank</u> when the checks had only been presented for payment to the <u>depository bank</u> but not actually cashed by the <u>drawee bank</u>.
- Solution: use certified check, wire the funds or use electronic transfer to make sure annual exclusion gift is made by year-end or prior to the date of death.

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Estate Valuation of Cryptocurrency

Estate of Matthew T. Mellon v. Commissioner, Docket No. 18446-22

- Estate held 530 million tokens of XRP, previously known as Ripple.
- Ripple imposed contractual liquidation restrictions on the decedent.
- Estate valued the crypto at $151 million.
- Appraisal applied a 40% discount to value the crypto. Used alternate valuation date. IRS rejected the discount and increased the value to $242 million.
- The appraisal considered the volatility of crypto in general, the uniqueness of the XRP tokens, the unpredictability of their market, blockage and other factors. The estate claimed the appraiser failed to give sufficient weight to the risk that XRP would be found to be a security and that further securities law restrictions would apply.
- Case may provide guidance on valuation of crypto for estate tax purposes.

IRS Changes Position on Sprinkling CRUT

CCA 202233014

- The IRS has allowed estate and gift tax marital deduction for transfers to a CRUT where some portion of the unitrust amount was payable at least annually to one or more persons (at least one of which is not an organization described in Section 170(c)), so more than a de minimus amount had to be paid annually to someone other than charity and the remaining portion of the unitrust amount could be distributed each year between a charity and the spouse in the trustee's discretion.

- In CCA 202233014 provided for 25% of the 5% unitrust amount of a testamentary CRUT be paid to the decedent's spouse and the remaining 75% could be paid either to charity or the spouse.

- IRS said a marital deduction was not allowed for the discretionary payment of the unitrust amount to the spouse and a charitable deduction was not allowed for the discretionary payment of the unitrust to charity because the amount payable to the spouse and charity was not ascertainable.

- IRS announced that it has changing its position taken in prior rulings.

Using a General Power of Appointment to Increase Basis

PLR 202206008

- Portion of a pre-September 25, 1985 trust (to be determined by a formula at the time of the power-holder's death) and not subject to a general power of appointment following the settlement of a dispute will not be included in the power-holder's gross estate.
- Trustee decided to exercise his discretion and granted the grantor's sole surviving child a power of appointment over certain assets which two beneficiaries opposed.
- Settlement agreement allowed the trustee to grant the child a testamentary general power of appointment to appoint the largest portion of the trust that could be included in the child's gross estate without increasing the amount of federal and state estate and GST tax the child would have to pay.
- This appears to be an attempt to increase the cost basis of the assets subject to the general power of appointment without increasing the child's federal and state transfer taxes.

Using a General Power of Appointment to Increase Basis

PLR 202206008

- IRS said (1) the trust would retain its GST grandfathered exemption and (2) only the trust property subject to the child's testamentary power of appointment would be included in the child's gross estate.

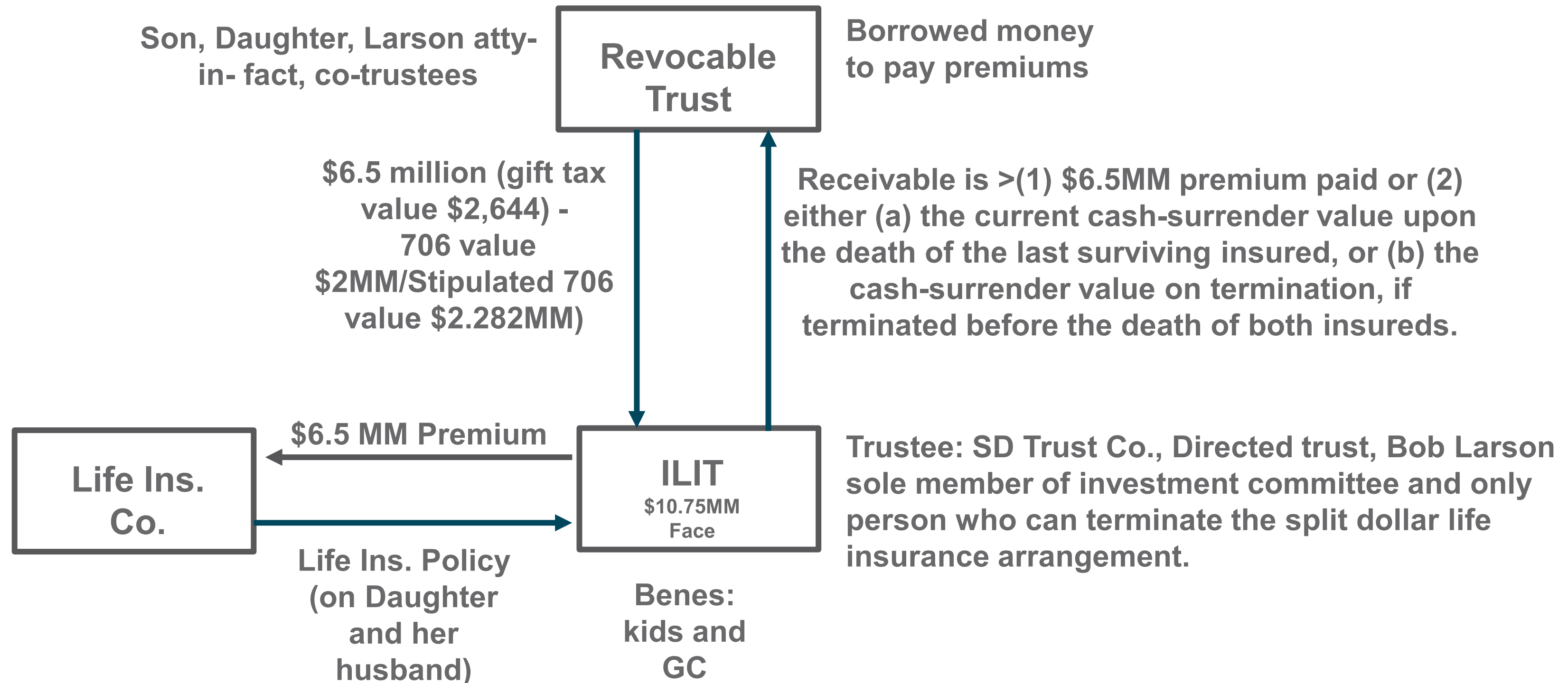
Gift Tax Value of Life Insurance Policies

Dematteo V. Commissioner, Tax Ct. Docket No. 3634-21 (July 21, 2022)

- Issue: How to determine the gift tax value of long-held life insurance policies.
- IRS says the value is the interpolated terminal reserve which is a complicated calculation for which the insurance companies give multiple values and leave it up to the taxpayer to determine the value to use.
- Taxpayer moved for summary judgment which the Tax Court denied stating that the value would be determined at trial.
- This may be an important case which establishes how to value gifts of life insurance policies.

Intergenerational Split Dollar Life Insurance

Estate of Levine, 158 T.C. 2 (February 28, 2022)



Intergenerational Split Dollar Life Insurance

Estate of Levine, 158 T.C. 2 (February 28, 2022)

- §2036(a)(2)/§2038(a)(1) holding:
  - Neither the cash surrender value nor the premiums paid were included in the decedent's gross estate under either §2036(a)(2)or §2038(a)(1).
  - Reason: the decedent did not have a right, alone or in conjunction with any other person, to terminate the policies or receive the cash surrender value of the policies – only the irrevocable trust (over which the decedent had no right to change, modify, amend or revoke) had those rights. Only Bob Larson, the independent, sole member of the investment committee, had the right to terminate the split-dollar arrangement.

- §2703 holding:
  - The IRS claimed that the split-dollar agreement was a restriction on the decedent's rights to obtain the $6.5 million of cash loaned to the ILIT under the split-dollar arrangement. IRS contended the restriction should be ignored under §2703.
  - Court held that §2703 only applies to a property interest (the split-dollar receivable) held by the decedent at the date of death. There were no restrictions on the split-dollar receivable, so §2703 didn't apply.

Intergenerational Split Dollar Life Insurance

Estate of Levine, 158 T.C. 2 (February 28, 2022)

- The distinguishing factors in Levine was (1) the decedent didn't have the ability to unwind the split dollar arrangement whereas in Morrissette the heirs were going to terminate the split dollar arrangement as soon as the estate tax statute of limitations expired and (2) there was a fiduciary obligation to the beneficiaries.

Income Tax Charitable Deduction – Conservation Easement

Hewitt v. Commissioner, (11th Cir. December 29, 2021)

- IRS denied income tax charitable deduction because the deed subtracted post-contribution improvements when dividing proceeds of sale upon termination of the easement to determine what the charity would get, thereby violating the "protected in perpetuity" requirement for conservation easements.

- Must give charity a percent of the gross proceeds, not net proceeds (value after subtracting post-contribution improvements).

- Deed language pulled from favorable private letter ruling.

- Conservation regulations invalid because the IRS failed to respond to comments (as required by the Administrative Procedure Act (APA)) during the notice and comment period.

Income Tax Charitable Deduction – Conservation Easement

Oakbrook Land Holdings LLC v. Commissioner, (6th Cir. March 14, 2022)

- Deed reduced the amount the charity would receive on termination by post-contribution improvements. IRS said the deed violated the “protected in perpetuity” requirement of the regulations.
- Sixth Circuit says under the Administrative Procedure Act (APA) the IRS only has to respond to germane comments to proposed regulations
- Holdings in Hewitt and Oakbrook Holdings result in split in the circuits

Administrative Procedure Act (APA)

Mann Construction, Inc. v. U.S., (6th Cir. March 3, 2022)

- §6707A(a) imposes a penalty on any person who fails to provide required information with respect to a "reportable transaction" (one that has a potential for tax avoidance or evasion) on a return.
- "Listed transactions" are a subset of reportable transactions – ones that have been specifically identified by the IRS as a tax avoidance transaction.
- Notice 2007-83 – certain life insurance policies are listed transactions.
- Company didn't know they were listed transactions.
- Company say Notice 2007-83 is invalid because it didn't comply with the APA notice and comment procedures for legislative rules.
- Company argued that the notice is new law (legislative) as opposed to interpretive rule – interpretive rules are exempt from APA's notice and comment requirements.
- 6th Circuit says taxpayer is correct.
- Sidenote: no Notice under §6707A has ever undergone the notice and comment requirements of the APA.
- Mann Construction denied cert. on January 9, 2023.

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Administrative Procedure Act (APA)

CIC Services LLC v IRS, 129 AFTR 2d 2022-1119 (E.D. TN March 21, 2022)

- Tennessee district court followed the result in Mann Construction (issued a few weeks earlier) and invalidated Notice 2016-66, which designates certain micro-captive transactions as "transactions of interest" subject to reporting obligations.
- CIC Services LLC is in the 6th Circuit so it must follow Mann Construction which is a 6th Circuit case.
- Court held that the Notice was invalid as it didn't follow the notice and comment procedures of the APA.

SECURE Act Proposed Regulations (February 24, 2022)

Changes

- Child reaches age of majority on his or her 21st birthday – plan benefits must be withdrawn by the minor child's 31st birthday

- Modifies the definition of "disabled" for a minor child and includes a safe harbor under which a beneficiary will be deemed disabled if, at the employee's death, the beneficiary is disabled under 42 U.S.C. §1382c(a)(3)

- If an trust has more than one beneficiary and any one of them is not an eligible designated beneficiary, then for purposes of applying the MRD rules, the trust will be deemed as having no EDB

SECURE Act Proposed Regulations (February 24, 2022)

Trusts as Beneficiaries Under the Proposed Regulations

- Retain the "see through" concept from existing regulations
- A trust created exclusively for the benefit of EDBs will be treated as an EDB.
- However, if the trust has one or more beneficiaries that are not EDBs, the trust will be treated as having no EDBs.

SECURE Act Proposed Regulations (February 24, 2022)

Beneficiaries of "See Through" Trust that are Disregarded for EDB Purposes

- Beneficiary who could receive a distribution from a trust holding an employee's interest in a plan only after the death of a remainder beneficiary won't count – that beneficiary's interest is "minimal or remote"
- A remainder beneficiary will also be disregarded where the terms of the trust require the complete distribution of the employee's account balance to an EDB by the later of the calendar year after the year of the employee's death or the end of the tenth year after the year in which the EDB attains the age of majority.
- Effective date of proposed regulations – January 1, 2022. However, IRS Notice 2022-53 extends the effective date to 2023.

SECURE ACT

Notice 2022-53

- No penalty for failure to take MRD in 2021 or 2022 – does this mean that no MRD were required to be taken in 2021 or 2022?
- Proposed regulations will not apply until 2023

Anti-Clawback Proposed Regulations

Provides an Anti-Abuse Rule

- Anti-clawback rules do not apply to taxable gifts included in the decedent's gross estate.
- Basically, transfers subject to the "string" provisions (§§2035, 2036-2038, 2042) and gifts of a note that remain unsatisfied at death can not use the exemption available at the date of the gift.
  - Any transfer, relinquishment or elimination of an interest, power or property within 18 months of the decedent's death is included as a transfer that may not use the exemption available at the date of the gift.
  - De-minimis exception: anti-clawback rules will apply to re-included transfers where the value of the taxable gift does not exceed five percent of the total value of the transferred property.
- Prevents use of higher gift tax exemption at the date of the gift if the transfer is pulled back into the gross estate when the exemption is lower.
- Effective date: decedents dying after April 26, 2022

Undivided Gift of Real Estate Valued Separately

Buck v. U.S. 128 AFTR 2d 2021-6043 (D.Ct. September 24, 2021)

- Gifts of undivided interests in real estate to separate donees in each of four years valued separately and not aggregated for valuation purposes.
- Donor gave 48% undivided interests in timberland to each of the donor's two sons over four years (the donor retaining the remaining 4%).
- The gifts were valued with a 55% discount for gift tax purposes.
- Valuing each gift separately is supported by the relevant statute, regulations and case law. The court did not mention Rev. Rul. 93-12 in which the IRS held that gifts of 20% of the stock in a closely-held corporation to each of the donor's five children should be valued separately without assuming that all voting power held by family members would be aggregated.
- See also TAM 9449001 and Mooneyham v. Commissioner, T.C. Memo. 1991-78 which are in accord with Buck v. U.S.

GRAT Valuation of Stock Pending Merger

Baty v. Commissioner – Settled Case – Tax Court Docket 12216-21

- IRS maintained that because the taxpayer intentionally undervalued stock contributed to a GRAT by not taking into account pending merger discussions, the taxpayer is not able to take advantage of the GRAT provisions (which would cause the entire amount contributed to the GRAT to be a taxable gift). The IRS also assessed penalties under §6662. The taxpayer valued the stock at $36.6 million while the IRS said the value was $55 million.

- This case was addressed in CCA 201939002 in which the IRS concluded that a stock on a listed exchange had to be valued for gift tax purposes by taking into consideration an anticipated merger of the underlying company that was expected to increase the value of the stock.

- No merger agreement had been reached at the time the stock was contributed to the GRAT. The IRS' contention that the value should take into consideration non-public information available to the taxpayer would violate securities laws.

- The IRS eventually conceded. Stipulated decision entered June 17, 2022.

GRAT Valuation of Stock Pending Merger

Baty v. Commissioner – Settled Case – Tax Court Docket 12216-21

- The IRS's position in the case was not the position announced in CCA 202152018 that the GRAT would not be a qualified GRAT and the entire contribution to the GRAT would be a taxable gift.

- Instead, the IRS claimed that the annuity payments would not be adjusted, so the difference between the IRS' value ($55 million) and value reported on the gift tax return ($36.6 million) was a taxable gift. In the alternative, the IRS claimed that the annuity interest would not constitute a qualified interest meaning that the retained annuity payments would be valued at zero.

Swap Transaction with GRAT and Section 16(b)

Donoghue v. Smith, 2022 U.S. Dist., LEXIS 76071 (S.D. N.Y April 26, 2022)

- Swap transaction with GRAT was a "purchase" for purposes of Section 16(b) short-swing profits rule.

- Section 16(b) permits recovery by a corporation of insider trading profits made from a purchase and sale within a 6 month period.

- Settlor (an "insider") of GRAT should be trustee to satisfy "mere change of form of beneficial ownership" exception under Section 16a-13 as then he would have "exercise or share investment control."

- Substitution power exercised to reacquire Class B shares, which were convertible into Class A shares. Within 6 months of the reacquisition, taxpayer, who was an "insider," transferred or sold Class A shares making $5.5 million in short-swing profit.

- In a shareholder derivative action, shareholders seek disgorgement of the $5.5 million profit under Section 16(b) of the Securities and Exchange Act of 1934.

Swap Transaction with GRAT and Section 16(b)

Donoghue v. Smith, 2022 U.S. Dist., LEXIS 76071 (S.D. N.Y April 26, 2022)

- Estate planners should work with securities attorneys in making these transfers.
- Receiving insider stock in satisfaction of the annuity payment and rolling the stock into a new GRAT may be treated as a purchase and sale of stock within 6 months.
- Lesson: any substitution of assets transaction (especially where the grantor is not a trustee) would constitute a "purchase" of securities that could be matched with any actual sale of securities in a market transaction or private third-party transaction, and the shares should not be sold in a market transaction or private third-party transaction within six months of any substitution of asset transactions.

Wandry Clause Gift Tax Case Settled

Sorensen v. Commissioner, T.C. Docket 24797-18 et. al. (Decision August 22 2022)

- Two brothers owned a chain of sandwich shops. They each used a Wandry clause to transfer $5 million of non-voting stock using their gift tax exemption to grantor trusts in 2014, followed in 2015, by a sale of $2.86 million of stock to the grantor trusts in return for a promissory note.
- Subsequently, in 2021, the company was sold for $1 billion cash with each of the two grantor trusts receiving $153 million.
- On audit, the IRS increased the value of the stock. The parties stipulated to the increased value of the stock and each brother paid gift taxes of $6.536 million.
- Results to the taxpayers: (1) Adjusting the shares based on the defined value clause would have resulted in $50 million of the sale proceeds being allocated to each grantor trust, rather than $153 million based on the IRS' increased valuation. Plus, using the defined value clause would have left more shares in the hands of the individual shareholders. (2) For a $6.536 million gift tax paid by each brother, they were able to transfer $153 million to the grantor trusts – an effective rate of tax of 4.3%. A huge transfer success.

Wandry Clause Gift Tax Case Settled

Sorensen v. Commissioner, T.C. Docket 24797-18 et. al. (Decisions August 22 2022)

- This case sets out the arguments the government is making in challenging Wandry clause gifts. It gives planners ideas of how to draft to avoid issues with defined value clauses.

- Also, the IRS challenged the appraisal because it was 3 months old. This is a case planners can present to clients who insist on using a dated appraisal for gift tax purposes to save appraisal fees.

Special Use Valuation on Late Filed Return Allowed

U.S. v. Parks, 130 AFTR 2d 2022-5379 (E.D. Mich. Nov. 18, 2022

- Special use valuation election may be made on the first estate tax return filed, even if it is five years late.
- A private letter ruling, the regulations and the IRS' own instructions so hold.

Trustee Personally Liable for Estate Tax

U.S. v. Allison, 129 AFTR 2d 2022-830 (E.D. Cal. Feb. 25, 2022)

- Trustees of decedent's revocable trust had personal liability for the decedent's estate tax, not necessarily under 31 U.S.C. §3713(b) (the federal priority statute) but under §6324(a)(2).
- §6324(a)(2) imposes personal transferee liability on all persons who receive or are in possession of property that was included in the decedent's gross estate, to the extent of that property's value at the time of the decedent's death. That includes property held by the decedent's revocable trust.
- Under 31 U.S.C. §3713(b) the personal representative of a decedent's estate is personally liable when the personal representative (1) transfers estate assets before paying a claim of the U.S., (2) effect a transfer of the estate's assets when the indebted estate is insolvent and (3) knows or should know of the debt owed by the estate to the U.S.
- As this case was decided on a summary judgment motion, there was insufficient facts to establish liability under 31 U.S.C. §3713(b).

Trustee Lacks Authority to Act for Decedent – Income Tax

Sander v. Commissioner, T.C. Memo. 2022-103 (Oct. 6, 2022)

- The trustee of the decedent's revocable trust lacks authority to act for the decedent in a deficiency proceeding on the decedent's income tax return. Only the decedent's personal representative has that authority.

- Under Florida law only a personal representative can defend claims against the decedent.

- Court gave the trustee (decedent's daughter) time to apply to be the estate's personal representative.

- Note: the Internal Revenue Code should be changed to take the definition of executor out of §2203 (which only applies to estate tax) and move it to §7701.

Generation-Skipping Transfer Tax

PLR 202215015

A pre-September 25, 1985 (GST grandfathered) trust will not lose its grandfathered status if (1) there is not a shift of beneficial interests those who occupy a lower generation than the persons who held beneficial interests prior to the change, or (2) the time for vesting of any beneficial interest in the trust is not extended beyond the period provided for in the original trust.

- The above rule has never been applied to a trust which is GST exempt due to the allocation of the GST exemption (as opposed to being grandfathered as a pre-September 25, 1985 trust).

- This ruling appears to apply the rule applicable to grandfathered trusts to GST exempt trusts to which the GST exemption has been allocated.

Relief for S Corporation Disqualification

Rev. Proc. 2022-19, 2022-41 I.R.B. 282 (Oct 7, 2022)

- Relief available without filing a private letter ruling for six enumerated faults resulting in inadvertent termination of an S corporation election.

SECURE 2.0 Act of 2022

Changes to Retirement Plans

- Biggest changes – extension of the age for minimum required distributions and the increased "catch-up" limits for people over 60.
- However, there are 90 different retirement changes overall in the Act.
- Some take effect immediately while others would start in 2024 or beyond.

SECURE 2.0 Act of 2022

Minimum Required Distributions

- Current law – MRDs from 401(k) and IRA account must begin at 72 (or 70 ½ for those turning that age before January 1, 2020).

- SECURE 2.0 Act of 2022 raises the age for MRDs to 73 starting January 1, 2023 and then further to age 75 starting January 1, 2033.

- New rules would also reduce the penalty for failing to take MRDs from 50% to 25% and to 10% if the error is corrected "in a timely manner." The penalty reductions would take effect immediately.

- Prior to SECURE 2.0 owners of Roth IRA were not required to take lifetime MRDs. Employees who saved in a Roth 401(k) were subject to MRDs. Beginning in 2024, employees with savings in a Roth 401(k) will not be subject to lifetime MRD. The same rule will now apply for the beneficiary of a Roth IRA and Roth 401(k).

SECURE 2.0 Act of 2022

One Time Election for Qualified Charitable Distribution to Split-Interest Entity

- Expands IRA charitable distribution provision to allow a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts and charitable remainder annuity trusts, effective immediately.

- The $50,000 is adjusted for inflation. Also indexes for inflation the IRA charitable distribution limit of $100,000 for qualified charitable distributions (QCD), effective for distribution made in taxable years after the date of enactment.

- Limits on the $50,000 distribution: (1) a distribution to a CRUT or CRAT will only count as a QCD "if such trust is funded exclusively by qualified charitable distributions." (2) the only income beneficiaries of the CRUT or CRAT can be the IRA owner and their spouse. In addition, the result is that such CRUTs or CRATs would be funded with Tier 1 ordinary income.

- Practical effect: only charitable gift annuities (CGA) will be used to take advantage of the $50,000 distribution provision. In addition, CGAs funded with the QCD require annuity payments to begin no less than one year after funding and those payments are set at a fixed rate of 5% or greater.

SECURE 2.0 Act of 2022

Statute of Limitations on Excess Contributions and Required Distributions

- Under current law, the statute of limitation starts to run when the Form 5329 is filed for excess contribution or missed required distribution.

- Statute of limitations would be 3 years from the time the taxpayer files a Form 1040 for the year of violation except for excess contributions where the statute of limitations will run 6 years after filing the Form 1040 for the year of violation

Marital Deduction

Formula Clauses - Advantages

- Adjusts automatically to the optimum marital deduction
- Eliminates need to revise estate planning documents every time the value of the estate changes
- Adjusts when the value of the decedent's estate is uncertain

Marital Deduction

Formula Clauses – Disadvantages

- Language is complicated.
- May delay settlement of estate until values are finally determined for estate tax purposes.
- Use of alternate valuation can change the amount of the marital deduction and basis of assets. Where administration expenses are deducted can also change the amount of the marital deduction.
- Changes in the applicable exclusion amount can change the amount passing to the marital deduction trust to the surprise of the surviving spouse.

Marital Deduction

Formula Clauses – Types

- Pecuniary – a fixed dollar amount.
  - True worth – funded at date of distribution values
  - Appreciation/depreciation borne by the residue trust
  - Can choose which assets are used to fund the trust
  - Doesn't share in income of the estate earned during administration, but, depending on state law, may bear interest if not paid within a reasonable period after the decedent's death.
  - Gain results if funded with appreciated property. Loss recognized if funded from estate but not from a trust (unless a §645 election is made). Assets receive a basis equal to the date of distribution value.
  - If funded in-kind, a second valuation is required. May accelerate recognition of IRD.

Marital Deduction

Formula Clauses – Types

- Fractional or residuary
  - Technically, the trust will receive an undivided interest in each asset
  - No gain or loss recognized on funding in-kind. Since no gain or loss is recognized, there is no increase in the cost basis of the assets transferred to the trust. Also, will not accelerate the recognition of IRD. Works well with estates with retirement assets.
  - The marital trust will automatically share in any increase or decrease in the value of the assets from the valuation date to the date of distribution.
  - Fractional formula will not provide an opportunity to allocate growth assets to the exemption trust and non or low growth asset to the marital trust. However, discretionary language could be included in the document to allow the fiduciary to allocate assets in-kind based on date of distribution values, rather than an undivided interest in each asset. If so, a second valuation will be needed.
  - Partial fundings result in changes in the applicable fraction

Marital Deduction

Formula Clauses – Types

- Estate tax value pecuniary clause
  - Uses estate tax values rather than date of distribution values
  - No gain is recognized on an in-kind funding
  - Rev. Rul, 64-19, 1964-1 C.B. 682 – can use estate tax values but must satisfy one of two requirements: (1) the fiduciary must satisfy the pecuniary bequest by distributing assets having an aggregate fair market value on the date of distribution amounting to no less than the dollar amount of the pecuniary bequest, or (2) the fiduciary must satisfy the pecuniary bequest by distributing assets fairly representative of the appreciation and depreciation in the value of all property available for distribution.

Marital Deduction

Funding Issues

- Administration expense election can effect the size of the marital deduction and credit shelter trust.
- If there no estate tax exemption remaining, use of administration expenses on the estate tax return will result in an estate tax circular calculation.
- Pay attention to the Hubert regulations. Distinguish between management expenses and transmission expenses (which will reduce the marital deduction).
- Election of alternate valuation will affect the size of the marital bequest as well as the basis of the assets in the marital trust.

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Marital Deduction

Drafting Tips

- Use a savings clause to state that the intent of the grantor, regardless of other provisions of the trust, is to qualify for the estate tax marital deduction and have a statement that the provisions of the trust are to be interpreted so that the marital deduction is allowed.

- Beware of assets that do not qualify for the marital deduction. Document should state that the marital deduction should first be funded with assets that qualify for the marital deduction. §2056(b)(2).

- Make sure any assets going to the surviving spouse under a settlement agreement is the result of a bona fide dispute. Otherwise, the amount is not deductible.

Planning for the Middle Rich

Foundation of Estate Planning

- Grantor trust is the foundation of estate planning. Fund with assets to get the appreciation out of the estate.
- Clients want control and income.
- Divide business entity into voting and non-voting. Keep the voting (control and distributions) and transfer the non-voting. Want client to give up control at least three years before death. Client could retain control of the investments but not distributions.
- Weakness in planning with grantor trusts is that Congress might change the grantor trust rules.

Planning for the Middle Rich

Foundation of Estate Planning

- To get income from the grantor trust put in cash now and when the client needs income swap in other assets and take the cash out and spend the cash thereby reducing the estate.
- Put spouse in as a beneficiary of the grantor trust. i.e., a SLAT
- When to use a GRAT – to transfer assets without using gift tax exemption.
- Want as much certainty as possible with valuation. Use a defined value clause to control valuation
- Upstream planning with general power of appointment in a grantor trust. Make subject to the approval of a non-adverse party. Formula of amount subject to the power is the amount of the remaining exemption that will not cause estate taxation and only applies to assets where the fair market value exceeds the basis.

Planning for the Middle Rich

Foundation of Estate Planning

- If there is a surviving spouse and there is a credit shelter trust and the value of the credit shelter trust and the spouse's outside assets are less than the exemption, modify the trust and give the spouse a contingent general power of appointment in favor of a creditor of spouse to get a basis step-up.

- Idea for rolling GRATs – execute original GRAT and attach a simple GRAT at the end so when the client wants to roll the assets into a new GRAT, you change the name, date and percentage payout of the attached GRAT and have the simple GRAT refer back to the provisions of the original GRAT.

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Choosing the Right Situs for a Trust

Things to Think About

- What are the important criteria?
- What are the mechanics of changing the situs?

Choosing the Right Situs for a Trust

Things to Think About

- Does the trustee have a duty to forum shop? Speaker says no.
- When setting up a trust, the document should give the trustee authority, but not a duty, to change the situs of the trust.

Choosing the Right Situs for a Trust

Things to Think About

- Status of the rule against perpetuities
- State income tax considerations
- Creditor protection of the beneficiaries
- Does the state have a directed trust statute. Delegated versus directed trust.
- Two issues with directed trust: (1) what powers does the trustee have and (2) what is the trustee's liability.
- Can you waive the diversification rules under the Uniform Prudent Investor Act? A clause stating the trustee has no duty to diversify does not excuse the trustee from a duty to monitor investments
- Does the state allow decanting? Don't know the tax consequences of decanting.
- Does the state allow a purpose trust?
- Does the state have an asset protection trust statute?
- Can you do a non-judicial settlement agreement?
- Can you do a trust modification under Sections 411(a) or (b) of the Uniform Trust Code?
- How do no-contest clauses work in the state? Does the state allow pre-mortem validation?
- What is the quality of the statutes, case law and the judiciary in the state?

How to Terminate Representation of a Client

Fundamental Principles to Keep in Mind

- There are ethical considerations to consider
- There is no 100% right to fire a client – there is a fiduciary relationship
- It is permissible to fire a client if there is no material adverse affect
- It may be permissible to fire a client when the client won't follow your advice
- It may be permissible to fire a client due to the client's diminished capacity
- Can terminate a client if action by the client is fraudulent, criminal or breaching a fiduciary duty.
- Best thing is to screen the client and decline to represent the client up front as there is no ethical issue with declining to represent a client

Installment Sales

Sale to an Intentionally Defective Grantor Trust

- When the trust ceases to be a grantor trust there is a taxable transaction and the tax consequences of the transition have to be determined.

Getting Rid of a Trustee

Options

- Easiest way – talk to the trustee and mutually agree to have the trustee resign. Perhaps there is an appropriate successor so the trustee will resign.
- If agreement can't be reached, read the trust document to determine if there are removal provisions or other administrative provisions which may be helpful in removing the trustee.
- If trust document is not helpful, determine what state law applies and if there are favorable provisions under state law, e.g., could do a non-judicial settlement agreement (NJSA) but the trustee is an interested party who has to consent.
- If another state has more favorable provisions for removing a trustee, consider a change of situs to that state.
- The session then focused on provisions of the Uniform Trust Code (UTC) and the Restatement (Third) of Trusts.

Getting Rid of a Trustee

Provisions Under the UTC and Restatement

- Non-judicial settlement agreement (NJSA) – must not violate a material purpose of the trust. The norm is for the trustee to resign and the trustee is released from liability. NJSA requires consent of all "interested persons."

- Modification of the trust – can violate material purpose of the trust only if the grantor agrees and all beneficiaries consent.

- Court-authorized removal for lack of cooperation among the trustees OR removal is in the best interests of the beneficiaries.

- Court authorized removal where there is a substantial change of circumstances and removal is in the best interests of the beneficiaries.

- Court ordered removal for cause or serious breach of trust – this is the longest and most expensive alternative due to the requirement that cause must be proved and extensive discovery will probably take place.

- Consider placing term limits in a trust.

Special Needs & Elder Law

Focus

- Main focus was on changes to minimum required distributions under the SECURE Act 1.0 and how to qualify for the stretch out as an "eligible designated beneficiary" as a "disabled" or "chronically ill" person.
- Disabled – meet the requirements of §72(m)(7)
  - Slightly different definitions for those age 18 and older and those under age 18
  - Social Security Administration safe harbor.
- Chronically Ill - §7702B(c)(2)
- Reviewed rules for Applicable Multi-Beneficiary Trusts (AMBT)
  - AMBT Type I
  - AMBT Type II

Anti-Money Laundering

Two Issues

- Corporate Transparency Act (CTA)
- Whether attorneys should be part of the money-laundering reporting system, i.e., should attorneys be part of the law enforcement system.
  - American Bar Association has, so far, been able to shield attorneys from reporting requirements and becoming part of the law enforcement regime.

Anti-Money Laundering

CTA - Background

- Enacted on January 1, 2021 as part of the National Defense Authorization Act. Final regulations were issued September 29, 2022.
- Establishes a central registry of individuals who are beneficial owners of legal entities.
- Focus of CTA is transparency and collecting data on people who are in control of smaller businesses.
- Corporations, LLCs and partnerships (reporting entities) must disclose to FinCEN information on the company itself and its “beneficial owners.” Reporting entities are those that are created by filing a document with the secretary of state or similar office. Exceptions exist for entities already heavily regulated, e.g., banks, charities.

Anti-Money Laundering

CTA – Information Required to be Reported

- Information required of those individuals who are "beneficial owners":
  - Full legal name
  - Date of birth
  - Photo from driver's license, U.S. passport, etc.
  - Residential address
- Information must be reported to company and the company must furnish the information to FinCEN and the information must be kept current.
- Information is only accessible by law enforcement and taxing authorities

Anti-Money Laundering

When Information Must Be Reported

- Companies in existence before January 1, 2024 - no later than January 1, 2025
- Companies formed after January 1, 2024 – within 30 days of formation
- Change in beneficial owners – within 30 days of change

Anti-Money Laundering

Penalties for Non-Compliance

- Civil - $500/day
- Criminal - $10,000/up to 2 years in prison

Obtaining a FinCEN Identification Number

- Those obligated to report their information can obtain an identification number from FinCEN called a FinCEN Identifier.
- Furnish FinCEN with full legal name, proof of identification and residential address and FinCEN will furnish a FinCEN Identifier which can be furnished to the reporting company to use to satisfy FinCEN reporting requirements. Company only needs to furnish the FinCEN number. FinCEN must be informed of any changes.

Anti-Money Laundering

Who is Subject to Reporting Requirements?

- "Reporting Company" – any entity whose creation requires a filing with a secretary of state or other governmental authority unless an exception applies.
  - Large operating company exception – physical presence in the U.S., at least $5 million of gross receipts or sales on prior year tax return, at least 20 full-time employees
- "Beneficial Owner" – an individual who (1) directly or indirectly owns or controls more than 25% of a reporting company, or (2) exercises "substantial control" over a reporting company (e.g., CEO, CFO, COO, general counsel or anyone with similar duties regardless of title).
- "Applicants" – person who actually files the document creating the company with the secretary of state or other governmental authority or directs or controls the filing of such a document.

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Moore – New Norms in Trust Law

Four Key Changes

- Providing trust related information to beneficiaries
- Decanting
- Nonjudicial settlements
- Directed trusts

Moore – New Norms in Trust Law

Four Key Changes

- Providing trust related information to beneficiaries
  - Unform Trust Code (UTC): trustee must notify “qualified beneficiary” and (1) furnish copy of trust on request and (2) provide annual report to current beneficiary. Beneficiary has one year statute of limitations from receipt to bring suit for breach of fiduciary duty.
  - Silent trusts – Delaware has a silent trust statute

- Decanting
  - Does trustee have a power to decant?
  - If decanting provision is in the trust, the trustee may also have a state statutory right to decant
  - Decanting is a fiduciary power and must be exercised in the beneficiary’s best interest and is consistent with the grantor’s intent.
  - All states have some form of notice requirement – Notice in SD and NV is optional.
  - The tax consequences of decanting are unclear
  - UTC says generally a trustee does not have a duty to decant

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Moore – New Norms in Trust Law

Four Key Changes

- Nonjudicial settlements agreements (NJSA)
  - Generally, you can modify anything a court could order and doesn't violate a material purpose of the trust.
  - UTC – covers representation of other beneficiaries. e.g., virtual representation.
  - Many institutional trustees prefer NJSA as opposed to decanting to avoid liability exposure present with decanting.
- Directed trusts
  - An area with lots of activity
  - Fiduciary and nonfiduciary decision-making assigned to others
  - Issue is how to draft a trust to give certain people certain powers
  - An area with the most litigation in recent years

Restricted Charitable Gifts

Issues

- Will conditions or restrictions on contributions reduce or eliminate the income tax benefits.
- Conditions and restrictions are usually embodied in a gift agreement or other contractual arrangements.
- The charity must determine if they are ceding too much control and unable to reconcile the conditions and restrictions with their mission and policies.
- Naming rights should be scrutinized and determine if “un-naming” rights should be retained under the agreement.

Restricted Charitable Gifts

Contents of a Charitable Gift Agreement

- Who are the parties
- Purpose of the gift agreement
- Conditions and restrictions
- Donor's intent
- Naming and un-naming rights – charity should have policy and procedures and avoid putting a "morality" clause in the gift agreement to avoid offending the donor
- Management fees that may be assessed against the gift – if silent, charity can charge a management fee. Seems like the ability to take restricted funds and convert to unrestricted funds.
- Who can enforce the terms of the gift
- What role, if any, will the donor play after the gift is made
- What happens if the purpose can no longer be carried out – dedicate to another purpose or gift over to another charity
- Include a clause that the gift agreement constitutes the entire agreement between the parties (merger clause).

Ethics and Privileges Landmines with Gifts and Form 709

Issues

- Ethical problems with joint gifts – joint representation. Issue arises most often with SLATs
- If conflict arises, should have an informed consent in writing and state that the party may have better result with separate representation.
- §2036 is an area where client may want to waive the attorney-client privilege.

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Ethics and Privileges Landmines with Gifts and Form 709

What the Attorney-Client Privilege Does Not Cover

- Non-client family member, e.g., child comes to meeting with parent.
- Workpapers of attorney – may be covered by the work product doctrine
- Correspondence with third parties
- Bills/invoices
- Dual purpose advice – is the primary purpose legal advice?
- Tax opinions – disclosed to avoid penalties
- Material where the privilege is waived
- Attorney as tax return preparer

Ethics and Privileges Landmines with Gifts and Form 709

Love This Quote

- If a client’s question begins with “Can’t we just . . .” The answer is probably NO.

Ethics and Privileges Landmines with Gifts and Form 709

Amending a Form 709

- Rev. Proc. 2000-34 – Language that must be added to the top of the first page of the amended return: "Amended Form 709 for the gift(s) made in [insert the calendar year the gift was made] in accordance with Rev. Proc. 2000-34, 2000-34 I.R.B. 186."

- Required to meet the adequate disclosure requirements to get the 3 year gift tax statute of limitations running.

Ethics and Privileges Landmines with Gifts and Form 709

IMPORTANT PRACTICE TIP

- Per Lisa Piehl, IRS Program Manager of Estate and Gift Tax Policy, the IRS has a list of all Form 2848 (Power of Attorney and Declaration of Representative) submitted by representatives.

- If representative has filed a Form 2848 and changed his/her address, the IRS may send a notice to the representative's old address. This is deemed to be notice to the representative.

- Those named as a representative continue to be considered as representing a taxpayer until they "withdraw" from such representation.

Ethics and Privileges Landmines with Gifts and Form 709

IMPORTANT PRACTICE TIP – HOW TO "WITHDRAW"

- Unless the representative has a list of clients for whom he/she filed a Form 2848, file a Freedom of Information Act (FOIA) request for a CAF (Central Authorization File) representative/client listing. This is known as a "CAF 77 request."

- The IRS will provide a printout or electronic copy of all of the representative current authorizations.

- The representative must then file a Form 2848 and write "WITHDRAW" across the top of the first page of the Form 2848 with a current signature and date below the annotation and send it to the same CAF unit where the form was originally filed. See the instructions to the Form 2848.

Retirement Plan Benefits Payable to Trusts – Who Counts

Testing a Trust for Minimum Required Distributions (MRD)

- Ten rules that allow a beneficiary to be disregarded for MRD purposes
- Involves four steps
  - Step 1: Pass the four trust rules
  - Step 2: List all potential beneficiaries
  - Step 3: Divide potential beneficiaries into two tiers – tier 1 and tier 2
  - Step 4: Apply certain “disregard” rules to determine “countable” beneficiaries

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 1: Pass the Four Trust Rules

- The trust is valid under state law;
- The trust is irrevocable;
- Furnish a copy of the trust to the plan administrator by October 31 of the year after the plan owner's death; and
- Beneficiaries are identifiable

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 2: List All Potential Beneficiaries

- Three disregard rules at this level
  - Disregard someone who is already dead, i.e., who predeceased the IRA owner.
  - Disregard people who don't exist yet, i.e., unborn issue.
  - Disregard any potential appointee under a power of appointment until the power is exercised. The takers in default count until the power is exercised.

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 3: Divide the Beneficiaries into Two Tiers

- Tier 1: those beneficiaries who could inherit once the IRA owner dies, i.e., they don't have to wait for someone else to die to get the IRA

- Tier 2: anyone who can get the IRA after the 1st tier beneficiaries die.

  – There is no such thing as a third tier beneficiary – there are only 1st and 2nd tier beneficiaries.

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain "Disregard" Rules to Determine "Countable" Beneficiaries

- Conduit trust – disregard all 2nd tier beneficiaries
- What is a conduit trust – a trust that is required to distribute to the trust beneficiary the entire distribution received from the retirement plan for the life of the conduit trust beneficiary

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain "Disregard" Rules to Determine "Countable" Beneficiaries

- Advantage of a conduit trust – the beneficiary is deemed to be the sole beneficiary of the retirement plan.
- If the beneficiary is a surviving spouse, the surviving spouse gets a life expectancy payout and the life expectancy is recalculated annually. The distribution will never run out. If the participant hasn't reached his RBD, the surviving spouse would not have to begin taking MRD until the deceased participant would have reached his RBD.
  - Not as good as an outright distribution to the surviving spouse where the spouse can do a spousal rollover

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain "Disregard" Rules to Determine "Countable" Beneficiaries

- How to write a conduit trust:
  - Have a separate paragraph for retirement plan distributions. Require the trustee to distribute MRD each year. If intended to qualify for the marital deduction, you have to require that the internal "income" of the IRA be distributed if greater than the MRD. To qualify for the marital deduction the trust should require a distribution of the greater of the MRD or the "income" of the trust.
  - Permit the trustee to withdraw principal for the spouse's standard of living. Allow the trustee to make discretionary distributions of principal to the surviving spouse.
  - The amount withdrawn from the retirement account by the trust should be distributed to the surviving spouse.

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain "Disregard" Rules to Determine "Countable" Beneficiaries

- Conduit trust for a child.
  - 10 year rule. If IRA owner died after his required beginning date (RBD), MRDs have to be taken over year 1-9 and completely distributed in year 10

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain “Disregard” Rules to Determine “Countable” Beneficiaries

- Accumulation trust
  - If a 1st tier beneficiary who is under 31 will receive an outright distribution before 31, you can disregard any 2nd tier beneficiary who will take after that 1st tier beneficiary. A minor child “eligible designated beneficiary” (EDB) can get a life expectancy payout while a minor.
  - The age 31 rule applies not only for a minor child of the retirement plan owner but for all minor children even if not the minor child of the retirement plan owner.
  - Thus, if the entire amount of the retirement plan assets is distributed outright to the minor before age 31, you can disregard any beneficiary who takes after that minor child.

Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain "Disregard" Rules to Determine "Countable" Beneficiaries

- Accumulation trust
  - Can also disregard a 2nd choice, 2nd tier beneficiary.
  - Example: trust says pay to spouse for life, then children for life, then to charity. The charity takes only after the children and is the 2nd choice, 2nd tier beneficiary so the charity can be ignored in determining "countable" beneficiaries.
  - Example: spray trust for spouse and children – they are all 1st tier beneficiaries. After death of spouse and children, the balance is payable to charity. Charity is 1st choice, 2nd tier beneficiary and cannot be ignored in determining "countable" beneficiaries.

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Retirement Plan Benefits Payable to Trusts – Who Counts

Step 4: Apply Certain “Disregard” Rules to Determine “Countable” Beneficiaries

- Accumulation trust
  - Example: trust pays to husband for life but if he remarries, to daughter if she survives and if not, to charity. Since the daughter can take <u>before</u> the husband’s death (she doesn’t have to wait until the husband dies, i.e., she takes when the husband remarries), daughter is a 1st tier beneficiary and charity is a 2nd tier beneficiary and the charity cannot be disregarded.

Retirement Plan Benefits Payable to Trusts – Who Counts

Six Possible Payout Rules

- First - non-designated beneficiary – 5 year rule if the plan owner dies before his RBD or the "ghost" life expectancy (remaining life expectancy of the deceased plan owner) if the plan owner dies on or after his RBD.
  - In this case a non-DB is better off than a regular DB. Reason: the non-DB could use the plan owner's remaining life expectancy where as a DB who is older than the plan owner would have a shorter payout period. i.e., 10 years. This would be the case where the participant died between age 73 and approximately age 80 or 81.
- Second – conduit trust – the MRD is the same as if the conduit trust beneficiary was named as the outright beneficiary.

Retirement Plan Benefits Payable to Trusts – Who Counts

Six Possible Payout Rules

- Third – Type II AMBT (applicable multi-beneficiary trust) – the sole life beneficiary is a disabled or chronically ill individual. They are EDB and the trust qualifies as a EDB during the lifetime of the disabled or chronically ill individual because nothing can be distributed to anyone else other than the disabled or chronically ill individual. You get the life expectancy payout over the disabled or chronically ill individual's lifetime. The remainder can go to charity and the charity doesn't have to be disregarded as a beneficiary.

- Fourth – trust with any countable beneficiary who is a minor child EDB of the deceased plan owner. The trust gets a life expectancy payout over the life expectancy of the oldest countable beneficiary.

  – Example: trust is for the benefit of four children and one of the four children is a minor. The MRDs are paid over the life expectancy of the oldest countable beneficiary.

Retirement Plan Benefits Payable to Trusts – Who Counts

Six Possible Payout Rules

- Fifth – if all countable beneficiaries of the trust are EDB but none are minors, the MRDs are paid out over the life expectancy of the oldest EDB
- Sixth – all countable beneficiaries but not all are EDB and no minor EDB and it is not a conduit trust – 10 year payout
  - If death before RBD, must distribute entire amount by the 10th anniversary of the date of the participant's death
  - If death is on or after the RBD, MRD must be taken in year 1-9 with complete distribution by year 10

Retirement Plan Benefits Payable to Trusts – Who Counts

What Happens if the are Post-Death Changes in the Trust

- Regulations have favorable provisions
- Any possibility that the trust can be changed after death can be ignored until it actually happens.
- You have until September 30 of the year after the death of the plan owner to change a trust and the IRS will give effect to the amendments, i.e., any amendments to the trust done by the beneficiary finalization date of September 30 of the year after the plan owner's death.
- If the change is made after the September 30 beneficiary finalization date, if the change makes the MRD rules more favorable it won't count but if it makes the MRD rules less favorable it will count.

Retirement Plan Benefits Payable to Trusts – Who Counts

What if the Problem is with the Beneficiary Designation Form

- You can't reform the beneficiary designation form.
- You can only fix things before the beneficiary finalization date that are in the trust instrument.

Retirement Plan Benefits Payable to Trusts – Who Counts

Other Four Disregard Rules

- Can disregard beneficiaries removed before the September 30 beneficiary finalization date by reformation or decanting.

- Can add a beneficiary by the September 30 beneficiary finalization date by reformation or decanting.

- Can make a qualified disclaimer by the September 30 beneficiary finalization date, i.e., given retroactive effect to the date of death.

- Can make a distribution to a beneficiary by the September 30 beneficiary finalization date and have that beneficiary eliminated as a countable beneficiary, e.g. distribution by the September 30 beneficiary finalization date to charity and have the charity disregarded.

Retirement Plan Benefits Payable to Trusts – Who Counts

Worst Rule in the Proposed Regulations – Multiple Trusts or Sub-trusts

- Example: trust for the benefit of four beneficiaries is divided into 4 separate accounts for the four beneficiaries – can be divided into separate accounts by December 31 of the year after the plan owner's death but those separate accounts are not recognized for MRD purposes.

- If you want separate MRD for the separate trusts, you have to name each trust individually as the beneficiary in the beneficiary designation form to get the separate MRD testing.
  - Exception: if there is any disabled or chronically ill beneficiaries at all, then the separate sub-trusts created under the single trust that was created as a beneficiary will be recognized as the beneficiary and tested separately.

Retirement Plan Benefits Payable to Trusts – Who Counts

Important Dates

- September 30 – beneficiary finalization date
- October 31 – copy of the trust has to be furnished to the plan administrator
- December 31 - date by which you can divide into separate accounts.

Thank you!

Disclosure Appendix

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