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Highlights of 2025 Heckerling Institute on Estate Planning

Estate Planning Council of Northern New Jersey

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Recent Developments and Planning Opportunities

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Recent developments and Planning Opportunities (cont'd)

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Tax Legislation Prospects for 2025 and the Fate of the 2017 Tax Act

- The applicable exclusion amount for federal estate, gift and generation-skipping transfer (GST) taxes will increase to $13,990,000 in 2025 from to $13,610,000 in 2024 (an increase of $ 380,000)
  - Thus, a married couple can pass nearly $28 MLN free of **federal** estate tax in 2025
- The gift tax annual exclusion will increase to $ 19,000 per donee in 2025 (up from $18,000 per donee in 2024
  - The gift tax annual exclusion for gifts to non-US citizen spouses will increase to $190,000 in 2025 (up from $185,000 in 2024)

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Tax Legislation Prospects for 2025 and the Fate of the 2017 Tax Act

- What is the impact on estate planning of the Republican trifecta in the election and, in particular, what does it potentially mean for the scheduled sunset of the temporarily doubled federal estate, gift and GST tax exemptions after December 31, 2025?

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Tax Legislation Prospects for 2025 and the Fate of the 2017 Tax Act

– Both the Recent Developments Panel and the Monday morning introductory panel had some good comments on overall costs, with social security and then debt interest being the two biggest government expenditures now.

– Short extension is possible. Per Austin Bramwell, there's "an 85% likelihood" of an extension.

– But we probably won't know until later in the year given how things work in Washington.

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Planning with the increased exclusion amount

- For the majority of clients full use of the exclusion is out of reach, but partial use of close to all of one exclusion may be possible, and SLATs can provide a safety net
  - Splitable SLATs – create a trust with only children as a beneficiary but a power of appointment in someone to add the spouse or allocate trust funds to the spouse later. Should be splitable.
  - One interesting variation on the SLAT could be where spouse's discretionary interest is limited to income or to an amount not to exceed an annual unitrust amount. You can then split the remainder.
  - With time possibly running out, be careful about transfer to spouse followed closely by a transfer by spouse using those funds to children or a SLAT. Don't use the same dollar amounts either. *Smaldino* case is the warning about that, even though much more prearranged.

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Planning with the increased exclusion amount

- For any client close to death, consider termination of non-exempt trusts or swaps to push assets back into the estate and obtain a basis step-up
- Interest rates are higher than they've been in the recent past, which affects estate planning as well
  - GRATs, leveraged sales, and loans require better investment performance to succeed
  - QPRTs may be worth considering again for the first time in many years

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Planning with the increased exclusion amount

- As a reminder, the 2017 Tax Cuts and Jobs Act (TCJA) provides for sunset of the higher exclusion and it will revert back to $5 MLN plus inflation adjustments in 2026. If sunset occurs, estimated amount in 2026 is $7.2 million.
- If TCJA is extended, estimated amount for 2026 is $14.4 million
- If sunset occurs, IRC Section 2010 "anti-clawback" regulations will prevent estate tax from applying to gifts that were tax-free only because of the higher exclusion.
- An estate generally will be able to calculate its estate tax credit using the **HIGHER** of the exclusion amount applicable as of the date of the gift or the exclusion amount applicable upon death.

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Planning with the increased exclusion amount

- Also included in the 2019 regulations was clarification that the taxpayer would need to "use it or lose it" by making gifts exceeding the historical exemption amount in order to take advantage of the temporarily increased exclusion amount.
  - For example, if a taxpayer made a gift of $ 5MLN today when the exemption amount is $13,990,000, and the exemption amount is reduced to $ 7MLN in 2026, the taxpayer would only have $2 MLN of exclusion remaining.
  - However, if the taxpayer made a gift of $13,990,000 using all of the increased exclusion amount, then there would be no "clawback" of the exemption previously used if the taxpayer died after 2026 when the exemption amount is reduced to only $7MLN in this example.

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Planning with the increased exclusion amount

- Proposed Regulations issued on April 26, 2022 make clear that transfers where the donor continues to have title, possession, or other retained rights in the transferred property under sections 2035, 2036, 2037, 2038 and 2042 of the Internal Revenue Code (resulting in estate inclusion) **do not qualify for the special anti-clawback rule** (subject to certain exceptions).
- For situations like these, the amount includible in the gross estate will only be given the benefit of the exemption amount available at the time of death.
  - The Proposed Regulations provide for exceptions to the Special Rule, and also exceptions to the exception in certain situations.

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Marital Trust Planning: The *Anenberg* Case

- Relevant Requirements of QTIP Marital Deduction Trusts
  - Must pass from the decedent to the surviving spouse; and
  - Spouse must have "qualifying income interest for life," meaning
    - Right to all income; and
    - No person can have power to appoint any of the property to any person other than the surviving spouse.
- *Estate of Sally J. Anenberg v. Comm'r*, 162 T.C. No. 9 (May 20, 2024)
  - Typical QTIP Marital Trust
  - Court ordered termination, consented to by children; distribution of all property to surviving spouse
  - Spouse engaged in further estate planning with trust property
  - IRS asserted that termination of Marital Trust was a taxable gift by the surviving spouse under section 2519 of the Internal Revenue Code
  - Court disagreed, finding no gift tax because spouse received trust interests

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Marital Trust Planning: The *McDougall* Case

- *Bruce E. McDougall v. Comm'r*, 163 T.C. No. 5 (Sept. 17, 2024)
  - Typical QTIP Marital Trust
  - The surviving spouse together with his children (who were the remainder beneficiaries of the QTIP Marital Trust) entered into an agreement under which the QTIP trust was terminated and all of its assets were distributed solely to the surviving spouse ("Bruce").
  - Bruce then promptly sold some of the assets he received from the QTIP Marital Trust to other trusts established for the benefit of his children and their descendants in exchange for promissory notes.
  - IRS asserted that termination of the Marital Trust was a taxable gift by Bruce under IRC section 2519, ***and also asserted that the agreement to terminate the Marital Trust constituted a gift by Bruce's children to Bruce.***
  - Following *Anenberg*, the Court found there was no gift by the surviving spouse (Bruce) because Bruce received the trust interests.
  - ***However, the Court held that the agreement to terminate the Marital Trust and give all of the trust property to Bruce constituted a gift by Bruce's children to Bruce.***

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Marital Trust Planning: Additional Considerations

- This issue of consent or failure to object invokes to some extent CCA 202352018 and shows a new area of emphasis by the IRS.
- Planning considerations in this new environment:
  - What planning can be done without children's affirmative involvement?
  - Use of renunciations by the spouse in states where that works.
  - Divide the QTIP trust first and plan with part spouse is willing to lose some benefit of, so don't taint the whole trust.

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Recent Supreme Court decisions will make it easier to challenge tax regulations – *Loper Bright* and *Corner Post*

- The following two recent Supreme Court decisions have overturned "*Chevron* deference" and make it easier to challenge the legal determinations of agencies in construing ambiguous federal statutes:
  - *Loper Bright Enterprises v. Raimondo*, 603 U.S. ___, 144 S.Ct. 2244 (2024); and
  - *Corner Post, Inc. v. Board of Governors the Federal Reserve System*, 603 U.S. ___ (2024).
- These two cases have meaningfully shifted the landscape of federal regulations, including those issued by the US Department of Treasury in construing the Internal Revenue Code.

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Recent Supreme Court decisions will make it easier to challenge tax regulations – *Loper Bright* and *Corner Post*

- Under *Loper Bright*, the benefit of the doubt granted to federal agencies in construing ambiguous federal statutes under the *Chevron* case (*Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*) (*i.e.*, "*Chevron* deference") **is now gone**.
- In addition, under *Corner Post*, the tolling of the statute of limitations to challenge a federal regulation received a very friendly reception by the Court. In tax cases, the timeframe for such challenge will generally be tolled until taxpayers receive a Notice of Deficiency from the IRS.
- Combined, these cases make it much easier to challenge a federal regulation, and "forum shopping" can be expected.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- *Estate of Fields v. Commissioner*, T.C. Memo. 2024-90 (9-26-24) (Copeland, J.), provides a textbook example of a bad-facts family limited partnership (FLP) that caused estate tax inclusion of the property transferred to the FLP under both section 2036(a)(1) and (2) with loss of discounts for lack of control and lack of marketability.
- In doing so, the court applied the Tax Court's 2017 holding in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017) -- that the ability of the decedent as a limited partner to join together with other partners to liquidate the FLP constitutes a section 2036(a)(2) estate tax trigger -- and raises the specter of accuracy-related penalties that may loom where section 2036 applies.

Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

– FACTS

- Anne Milner Fields ran an oil business she inherited when her husband passed away in the 1960s.
- Her great nephew, Bryan Milner, was the primary beneficiary of her wealth.
- In her later years she relied on Mr. Milner to take care of her and manage her assets, entrusting him with a general durable power of attorney.
- Mr. Milner ultimately exercised this power of attorney to implement an estate plan involving a FLP about a month before Ms. Fields' death on June 23, 2016.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- **FACTS (cont'd)**
  - On May 20, 2016, Mr. Milner formed AM Fields Management, LLC (AM Fields Management), of which he was the sole member and manager.
  - He then formed AM Fields, LP (AM Fields) on May 26, 2016, with AM Fields Management as the GP and Ms. Fields as LP.
  - Mr. Milner signed all the documents (including as agent under a durable power of attorney for Ms. Fields, who had severe Alzheimer's).
  - Afterwards, he used his power of attorney to transfer to AM Fields approximately $17 million of Ms. Fields' assets (more than 85% of her wealth). Of the assets transferred, more than $15.3 million consisted of marketable securities, with the balance comprised of land and interests in closely held entities.
  - AM Fields Management contributed $1,000 to AM Fields as its capital contribution. In exchange for the contributions, Ms. Fields received a 99.9941% LP interest in AM Fields, and AM Fields Management received a 0.0059% GP interest.

Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- **FACTS (cont'd)**
  - Ms. Fields passed away on June 23, 2016.
  - The appraiser valued the interest at $10.8 million as of Ms. Fields' date of death -- a 36.25% aggregate discount from the approximately $17 million in assets that she contributed to the FLP approximately one month before her death.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- **FACTS (cont'd)**
  - The IRS audited the estate tax return and attacked the claimed discount under section 2036(a)(1) and (2).
  - In a Notice of Deficiency, the IRS asserted that section 2036(a) applies such that the gross estate includes the full date-of-death value of Ms. Fields' assets that were contributed to AM Fields without any discount for lack of control or lack of marketability.
  - The IRS also asserted an accuracy-related penalty against the Estate under section 6662(a) and (b)(1) due to negligence or disregard of rules or regulations.
  - Litigation in the Tax Court followed.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- **Section 2036 Analysis**
  - The Tax Court observed that there are three requirements for property to be included in the gross estate under section 2036(a).
    - ***First***, the decedent must have made an inter vivos transfer of property (which was undisputed here).
    - ***Second***, the decedent must have retained an interest or right specified in section 2036(a)(1) or (2) in the transferred property that he or she did not relinquish until death.
    - ***Third***, the transfer must *not* have constituted a bona fide sale for adequate and full consideration.
- **Section 2036(a) provides that "[t]he value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (*except in case of a bona fide sale for an adequate and full consideration in money or money's worth*), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death –**

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."

Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- ***Retained Interest under Section 2036(a)(1)***
- The court found that Ms. Fields retained an interest in the property that she transferred to the FLP under section 2036(a)(1).
- As a result of Mr. Milner's dual role as attorney-in-fact under Ms. Fields' power of attorney and as the manager of the GP, Ms. Fields effectively held the right to virtually all the income from her transferred assets, and the AM Fields partnership agreement constituted an express agreement to that effect.
- In addition, the court found an implicit agreement between Mr. Milner and Ms. Fields that he, as manager of AM Fields's GP, would make distributions from the partnership to satisfy her expenses, debts, and bequests if any when necessary.
- The use of a significant portion of partnership assets to discharge obligations of a decedent's estate [including bequests and estate taxes] is evidence of a retained interest in the assets transferred to the partnership.
- Virtually nothing beyond formal title changed in decedent's relationship to her assets.
- The $1,000 general partner interest that AM Fields acquired in the FLP was considered *de minimis* by the court and did not give rise to a pooling of interests to potentially alter this result.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- ***Retained Right to Designate Enjoyment of Property under Section 2036(a)(2)***
- Relying on *Estate of Powell v. Commissioner*, 148 T.C. 392, 402 (2017), the court then held that estate tax inclusion was also triggered under section 2036(a)(2) by virtue of Ms. Fields' retention of the right, as a limited partner, to act in conjunction with the general partner to dissolve the FLP and cause its liquidation.
- As in *Powell*, the court took a literal construction of the language of section 2036(a)(2) which taints "the right, *either alone or in conjunction with any person*, to designate the persons who shall possess or enjoy the property or the income therefrom." (Section 2036(a)(2) (emphasis added))

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- *Bona Fide Sale Exception to Section 2036 Not Available under These Circumstances*
- The court next considered whether section 2036's exception for transfers constituting a "bona fide sale for an adequate and full consideration in money or money's worth" might spare the taxpayer from section 2036's reach.
- The bona fide sale prong, in turn, requires a "substantial nontax purpose" – as the court put it, an objective determination by the finder of fact as to what, if any, nontax business purpose the transfer was reasonably likely to serve at its inception.
- The objective evidence must indicate that the nontax reason was a significant factor that motivated the family limited partnership's creation.
- A significant purpose must be an actual motivation, not a theoretical justification.
- The decedent's age and health at the time of the transfer may be considered for this purpose.

Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- ***Bona Fide Sale Exception to Section 2036 Not Available under These Circumstances (cont'd)***
- Relying principally on Mr. Milner's testimony, the Estate argued that there were four substantial nontax purposes behind Ms. Fields' capital contributions to the FLP:

  1. The FLP protected Ms. Fields from further instances of financial elder abuse (which she had sustained several years earlier).
  2. The FLP allowed for succession management of assets by permitting Mr. Milner to designate his successor.
  3. The FLP resolved concerns that third parties, such as banks, may refuse to honor Ms. Fields' power of attorney (which had occurred several years earlier).
  4. The FLP allows for consolidated and streamlined management of assets.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- ***Bona Fide Sale Exception to Section 2036 Not Available under These Circumstances (cont'd)***
- The court found Mr. Milner's testimony on non-tax objectives *not to be credible*.
- Rather, the court found the establishment of the FLP to be motivated by the desire to save estate taxes, and considered particularly telling an email from Mr. Milner's attorney to the appraiser that inquired about "obtaining a deeper discount" for tax purposes.
- The timeline for establishment and funding of the FLP coincided with Ms. Fields' precipitous decline in health, as she suffered from severe Alzheimer's and died approximately one month after the partnership was funded.
- The transfers of assets to the FLP depleted Ms. Fields' liquidity to the point that the Estate could not pay Ms. Fields' bequests under her Will or its estate tax liability without receiving substantial distributions from the FLP.
- In light of these circumstances, the court determined that "it seems more likely that the four putative nontax purposes are post hoc "theoretical justifications" rather than "actual motivations."
- The Estate therefore failed to meet its burden of proof that the transfers to the FLP constituted bona fide sales to qualify for the exception to Section 2036.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- ***The Amount of the Section 2036 Inclusion***
- The court then addressed the amount of the section 2036 inclusion, and relied upon *Estate of Moore*, T.C. Memo. 2020-40 (2020) for its analysis.
- Under *Moore*, one must consider the date of death value of both the limited partnership interest (under section 2033) and the transferred partnership property (under section 2036), and then offset against it under section 2043(a) the value of the transferred property as of the date of transfer.
- Because neither party argued that there was appreciation or depreciation in the value of the transferred property between the date of transfer and the date of death, the section 2033 and section 2043(a) components canceled each other out producing estate tax inclusion of the date of death value of the transferred property without any discount.
  - A separate 5.7% illiquidity discount was also allowed for certain thinly traded stock transferred to the FLP, with the court adopting the IRS valuation expert's view as to the amount of this discount.

Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

- ***Accuracy-Related Penalty***
- Finally, the court reviewed the IRS's imposition of a 20% accuracy-related penalty under section 6662(a) and (b)(1) on the underpayment of estate tax required to be shown on the estate tax return due to either negligence or the disregard of rules or regulations.
- Section 6662(c) provides that the term "negligence" includes any failure to make a reasonable attempt to comply with the Code, and the term "disregard" includes any careless, reckless, or intentional disregard.
- In addition, section 6664(c)(1) provides that "[n]o penalty shall be imposed under section 6662 . . . with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."
- The Estate bears the burden of proof regarding the reasonable cause defense.

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Estate of Fields and IRS challenges to family limited partnerships including due to the retained ability to participate in partnership liquidation decisions

– ***Accuracy-Related Penalty (cont'd)***

– The Estate argued that Mr. Milner, in his capacity as executor, had reasonable cause for any underpayment and acted in good faith in determining the Estate's estate tax liability.

– The court rejected this assertion because Mr. Milner never contended that he personally considered, researched or understood the implications of section 2036 upon the Estate's estate tax liability.

– As the court put it, "a reduction of approximately $6.2 million in the Estate's reportable assets thanks to the seemingly inconsequential interposition of a limited partner interest between Ms. Fields and her assets on the eve of her death would strike a reasonable person in Mr. Milner's position as *very likely too good to be true*." (emphasis added)

– Moreover, the record did not show that Mr. Milner actually relied in good faith on an adviser's judgment in discounting the value of Ms. Fields' limited partner interest without considering the application of section 2036.

– The Estate therefore failed to meet its burden of establishing reasonable cause, and consequently was liable for the 20% accuracy-related penalty on the underpayment of estate tax.

CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

- CCA 202352018 was released on December 29, 2023 and addresses the gift tax consequences of modifying a grantor trust to add a tax reimbursement clause.
- This CCA phrased the issue as follows:
  - What are the gift tax consequences to the beneficiaries when the trustee of an irrevocable trust [that is treated as a grantor trust as to its owner for federal income tax purposes] modifies the trust, ***with the beneficiaries' consent***, to add a tax reimbursement clause that provides the trustee the discretionary power to make distributions of income or principal from the trust in an amount sufficient to reimburse the grantor for income tax attributable to the inclusion of the trust's income in the grantor's taxable income?
- The CCA reaches the following conclusion:
  - The modification to add the tax reimbursement clause will constitute ***a taxable gift by the trust beneficiaries*** because the addition of a discretionary power to distribute income and principal to the grantor is a relinquishment of a portion of the beneficiaries' interest in the trust.

CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

- In its recitation of facts, the CCA notes the following:
  - In Year 1, the grantor "A" establishes and funds an irrevocable inter vivos trust for the benefit of A's Child and Child's descendants
  - Under the governing instrument of the Trust, the trustee (who is not related or subordinate to the grantor within the meaning of Section 672(c) of the Code) may distribute income or principal to or for the benefit of Child in the trustee's absolute discretion. Upon Child's death, the Trust's remainder is to be distributed to Child's issue, *per stirpes*.
  - Under the governing instrument of the trust, A retains a power that causes A to be the deemed owner of the Trust under the grantor trust rules and, accordingly, all items of income, deductions and credits attributable to Trust are included in A's taxable income.

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CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

- *Recitation of facts continued*
  - Neither State law nor the governing instrument of Trust requires or provides authority to a trustee of Trust to distribute to A amounts sufficient to satisfy A's income tax liability attributable to the inclusion of Trust's income in A's taxable income.
  - In Year 2, when Child has no living grandchildren or more remote descendants, Trustee petitions the State Court to modify the terms of the Trust.
    - Pursuant to the applicable state statute, Child and Child's issue consent to the modification.
    - Later that year, the State Court grants the petition and issues an Order modifying the Trust to provide a trustee of the Trust the discretionary power to reimburse the grantor A for any income taxes A pays as a result of the inclusion of Trust's income in A's taxable income.

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CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

– *CCA's Analysis*

- In developing its analysis, the CCA observed the following:
  - Treas. Reg. Sec. 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax applies to gifts indirectly made. Further, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to gift tax.
  - Treas. Reg. Sec. 25.2511-1(e) provides that if a donor transfers by gift less than their entire interest in property, the gift tax is applicable to the transferred interest. ***Further, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift.***
  - Under Reg. Sec. 25.2511-2(a), the measure of the gift is the value of the interest passing from the donor with respect to which the donor has relinquished its rights without full and adequate consideration in money or money's worth.

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CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

– *CCA's Analysis (cont'd)*

- Treas. Reg. Sec. 25.2511-2(b) provides that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for their own benefit or for the benefit of another, the gift is complete.
  - If a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among the donor's descendants, no portion of the transfer is a completed gift.
  - On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or X's heirs, the entire transfer would be a completed gift.
- The CCA also distinguished Rev. Rul. 2004-64, which addressed provisions in the governing trust agreement which either mandated or gave the trustee discretionary authority to make a distribution reimbursing the grantor for taxes.
  - In both these situations, when the trustee of the trust reimburses the grantor for income tax paid by the grantor, Rev. Rul. 2004-64 concludes that the payment does not constitute a gift by the trust beneficiaries because the distribution was either mandated by the terms of the governing instrument or made pursuant to the exercise of the trustee's authority granted under the terms of the governing instrument.

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CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

- *CCA's Analysis (cont'd)*
  - The CCA concludes:
    - As a result of the Year 2 modification of the Trust, grantor A acquires a beneficial interest in the trust property in that A becomes entitled to discretionary distributions of income or principal from the Trust in an amount sufficient to reimburse grantor A for any taxes A pays as a result of the inclusion of Trust's income in A's gross taxable income.
    - ***In substance, the modification constitutes a transfer by Child and Child's issue for the benefit of A.***
    - This is distinguishable from the situations in Rev. Rul. 2004-64 where the original governing instrument provides for a mandatory or discretionary right to reimbursement for the grantor's payment of income tax.
    - **Thus, as a result of the Year 2 modification, Child and Child's issue have made a gift of a portion of their respective interests in income and/or principal.**
    - ***The result would be the same if the modification was pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise the right to object.***

CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

– *CCA's Analysis (cont'd)*

  – ***The CCA further concludes by noting that the gift from Child and Child's issue of a portion of their interests in trust should be valued in accordance with the general rule for valuing interests in property for gift tax purposes***.
  – In a footnote, the CCA adds that "***[a]though the determination of the values of the gifts requires complex calculations, Child and Child's issue cannot escape gift tax on the basis that the value of the gift is difficult to calculate***."

CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

- *Observations*
  - The CCA is very daunting on its face, and potentially could apply to any trust modification to which a beneficiary fails to object, such as a trust decanting.
    - But is its analysis complete, or is there another aspect of the gift tax regulations that should also be considered?
  - Taking a step back, let's consider what's happening as a result of the beneficiary's consent to this trust modification.
    - In effect, a discretionary beneficiary of a trust is consenting to add another beneficiary (the grantor) while continuing in his status as a trust beneficiary.
    - Under many states' laws [including that of New York under NY EPTL § 7-3.1(a)], this constitutes a ***"self-settled trust"*** **because the beneficiary is effectively making a transfer to a trust of which he is a discretionary beneficiary; such** transfer would be considered void against the transferor's creditors.
    - If the transfer is void against the transferor's creditors, that means that the transferor has retained the "string" of being able to deny other beneficiaries from obtaining access to the trust property by being able to relegate his creditors to the trust property instead.

CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

– *Observations*

- The transfer tax consequences of self-settled trust treatment can be very significant.
  - Under Rev. Rul. 76-103, a transfer to a self-settled trust to which the transferor's creditors can be relegated causes the gift to be considered *incomplete* for federal gift tax purposes because the transferor has retained the ability to divert the trust property from the other beneficiaries in favor of his creditors.
  - The gift generally would not become complete for federal gift tax purposes until the trust property is distributed out of the trust to the beneficiary (should that ever occur), and then only in the amount of such distribution.
- As a corollary to incomplete gift treatment, the death of the beneficiary who is a deemed transferor to a self-settled trust may create exposure to estate tax under IRC Section 2036(a)(1).
  - Note, however, that there is an exception to estate tax inclusion under Section 2036 [including for Section 2036(a)(1)] where there is a bona fide sale for full and adequate consideration in money or money's worth.
  - Query whether this circumstance—particularly where an independent trustee has instituted the trust modification—could potentially invoke the "bona fide sale exception" to Section 2036.

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CCA 202352018 – gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

– This Issue Is Entirely Avoidable in the Context of Grantor Trusts

- First, this issue can be avoided by giving the trustee the discretionary power to reimburse the grantor for income taxes attributable to grantor trust status.
  - In certain states [such as New York under NY EPTL § 7-1.11(a)], this reimbursement power exists under default principles of state law without having to be expressly conferred in the trust instrument -- in the case of New York pursuant to NY EPTL § 7-3.1(d), without creating self-settled trust concerns for purposes of IRC Section 2036(a)(1) with respect to the trust's grantor.
- In addition, this issue can be avoided by having the trustee loan funds to the grantor in an amount sufficient to help defray the grantor's income tax liability that is attributable to grantor trust status.
  - This has the additional benefit of creating a liability (as a result of the loan) to reduce the net value of the grantor's taxable estate for federal estate tax purposes.

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What Does the Corporate Transparency Act (CTA) Require?

- A **Reporting Company** must disclose information about the entity itself, the **Company Applicant**, and its **Beneficial Owners** to the Financial Crimes Enforcement Network (FinCEN) of the Department of Treasury.
- For each Beneficial Owner or Company Applicant, the disclosure must include
  - Full legal name and date of birth;
  - Each Beneficial Owner's current residential address, and each Company Applicant's current business address; and
  - An identification number (such as a driver's license or passport number) or **FinCEN Identifier** number (available upon request from FinCEN after providing name, address, and date of birth) and a digital copy of the identifying document.
- Effective January 1, 2024

Reporting Companies

- The Act defines a Reporting Company as:
  - A corporation, LLC, or other similar entity that is
    1. Created by filing a document with a secretary of state or a similar office under the law of a State or Indian Tribe; or
    2. Formed under the law of a foreign country and registered to do business in the United States by the filing of a document with the secretary of state or a similar office under the laws of a State or Indian Tribe.
- LPs and business trusts (statutory trusts) are "similar" entities
- Trusts are excluded from this definition
- General partnerships appear to be excluded

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Reporting Company Exemptions

- The Act **excludes twenty-three types of entities** from qualifying as a Reporting Company, including:
  - A "*Large Operating Company*"
    - With more than 20 full time employees in the United States
      - 30 hours a week or 130 hours per month
    - With gross receipts or sales as reported on a federal income tax return of over $5 million
      - Must be U.S. sourced income
    - With an operating presence at a physical office within the United States
  - 501(c) tax-exempt charitable organizations and foundations
  - 4947(a)(1) and (2) charitable and split interest trusts
  - Various regulated entities (*e.g.*, banks, investment advisers, insurance companies, registered public accounting firms, pooled investment vehicles, etc.)
  - Subsidiary of an exempt entity
  - Certain inactive entities formed on or before January 1, 2020

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Who is the Beneficial Owner?

Beneficial Owner	Not a Beneficial Owner
An individual who	• A minor child (as defined in the State **in which the entity is formed**) if the information of the parent or guardian of the minor child is reported in accordance with the Act, until the child reaches the age of majority.
• Directly or indirectly • Through any contract, arrangement, understanding, relationship, or otherwise—	• An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual.
(i) Exercises **substantial control** over the entity; **or**	• An individual acting **solely** as an employee of reporting company and whose control over or economic benefits from such entity is derived **solely** from the employment status of the person. This does not apply to senior officers (*e.g.*, CEO, CFO, COO, GC, President).
(ii) Owns or controls at least 25% of the ownership interests of the entity.	• An individual whose only interest in a reporting company is through a (future) right of inheritance.
	• A creditor of a reporting company, unless the creditor otherwise falls within the definition of a Beneficial Owner.

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When is a Report Due?

- Initial Report
  - Existing Reporting Companies- by January 1, 2025
  - Reporting Company formed/registered on January 1, 2024 and after—30 calendar days (extended to 90 days for 2024 only)
- Updated Report
  - Within 30 calendar days after there is any change to any information previously submitted to FinCEN.
    - Change in who the Beneficial Owners are
    - Minor reaching age of majority
    - Information related to a Beneficial Owner (like a change in address or change in drivers license number)
    - An entity becomes exempt from reporting OR is no longer exempt
    - If a Beneficial Owner dies, a change occurs when the estate is "settled" – this term is not defined

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Penalties

- An individual who ***willfully*** provides false or fraudulent information, or ***willfully*** fails to report complete or updated Beneficial Ownership information, faces a civil penalty of $500/day as indexed ($591/day in 2024) while the violation continues or is not remedied, and a criminal fine of up to $10,000, and/or 2 years imprisonment
  - There is a 90-day safe-harbor if an individual voluntarily submits a report containing correct information

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Constitutional Challenges to the CTA

- On March 1, 2024, in *National Small Business United v. Yellen*, the U.S. District Court for the Northern District of Alabama held that the CTA was unconstitutional because it exceeded Congress's enumerated powers.
- In response to the federal district court's ruling, FinCEN issued a release on March 4, 2024 stating that it would comply with the federal court's order and would not enforce the CTA against the plaintiffs in that lawsuit, including members of the National Small Business Association (NSBA) as of March 1, 2024.
- Significantly, FinCEN makes no reference in its March 4th release to ceasing enforcement of the CTA against any parties other than the plaintiffs in that lawsuit including NSBA members as of March 1, 2024.

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Constitutional Challenges to the CTA

- In *Firestone v. Yellen, 2024 WL 4250192* (D. Ore. Sept. 20, 2024), a U.S. District Court rejected a plaintiff's motion for a preliminary injunction against the enforcement of the CTA because the CTA was likely to survive several constitutional challenges.

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Constitutional Challenges to the CTA (cont'd)

- On December 3, **everything changed**, as the United States District Court for the Eastern District of Texas issued a nationwide preliminary injunction barring the enforcement by the US government of the CTA.
- The case in which the nationwide preliminary injunction was issued is *Texas Top Cop Shop, Inc. v. Garland* (E.D. Tex. Dec. 3, 2024). In its order, the court determined:

  (1) the plaintiffs in the case (an individual, three small businesses, the Libertarian Party of Mississippi, and the National Federation of Independent Business (NFIB)) are likely to suffer irreparable harm in the absence of preliminary relief,

  (2) the plaintiffs have demonstrated a substantial likelihood of success in arguing that the CTA is unconstitutional,

  (3) the harm posed by the CTA outweighs any damage that the preliminary injunction may inflict on the government, and

  (4) injunctive relief would not harm the public interest.

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Constitutional Challenges to the CTA (cont'd)

- The preliminary injunction was sought by the plaintiffs only on behalf of themselves and the NFIB's approximately 300,000 members.
- However, the court determined that a nationwide ban on the CTA's enforcement would be appropriate, as the NFIB's membership extends across the country, and the plaintiffs could not receive meaningful relief without a nationwide preliminary injunction.
- Thus, under the terms of the court's order, the CTA is enjoined entirely, as is the primary reporting rule (for BOI reporting) that was issued under it by FinCEN.
- The court's order further bars enforcement of the January 1, 2025 BOI reporting deadline.

Constitutional Challenges to the CTA (cont'd)

– On December 5th, the government filed a notice of appeal of this preliminary injunction to the US Court of Appeals for the Fifth Circuit.

– On December 6th, FinCEN posted on its website the following statement concerning the Texas federal court preliminary injunction:

> *In light of a recent federal court order, reporting companies are not currently required to file beneficial ownership information with FinCEN and are not subject to liability if they fail to do so while the order remains in force. However, reporting companies may continue to voluntarily submit beneficial ownership information reports.*

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Constitutional Challenges to the CTA (cont'd)

- As of this writing, CTA compliance is still voluntary and the following appears on the FinCEN website:
- *In light of a recent federal court order, reporting companies are not currently required to file beneficial ownership information with FinCEN and are not subject to liability if they fail to do so while the order remains in force. However, reporting companies may continue to voluntarily submit beneficial ownership information reports.*

****

- On January 7, 2025, in the case of *Smith, et al. v. U.S. Department of the Treasury, et al.*, 6:24-cv-00336 (E.D. Tex.), the U.S. District Court for the Eastern District of Texas, Tyler Division, issued an order enjoining the government from enforcing the CTA against the plaintiffs and staying FinCEN's regulations implementing the CTA's reporting requirements (31 C.F.R. § 1010.380). On February 5, 2025, the Department of Justice—on behalf of the Department of the Treasury (Treasury)—filed a notice of appeal of the district court's order and, in parallel, has sought to stay that order as the appeal proceeds.
- If the district court's order is stayed, thereby allowing FinCEN's Reporting Rule to come back into effect, FinCEN intends to extend the reporting deadline for all reporting companies 30 days from the date the stay is granted. Further, in keeping with Treasury's commitment to reducing regulatory burden on businesses, FinCEN, during that 30-day period, will assess its options to modify further deadlines or reporting requirements for lower-risk entities, including many U.S. small businesses, while prioritizing reporting for those entities that pose the most significant national security risks.
- In the meantime, FinCEN is complying with—and will continue to comply with—the district court's order for as long as it remains in effect. As a result, FinCEN is not currently enforcing the CTA against the plaintiffs in that action—Samantha Smith and Robert Means—and their related entities, and FinCEN is also not currently enforcing the requirements of 31 C.F.R. § 1010.380 against any individual or entity. Reporting companies are, therefore, not currently required to file beneficial ownership information with FinCEN. Reporting companies may continue to voluntarily submit beneficial ownership information reports, free of charge, using FinCEN's E-Filing system. More information is available at fincen.gov/boi.

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The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

- In *Connelly v. U.S.*, 602 U.S. ___ (6/6/2024), the United States Supreme Court affirmed a decision of the Eighth Circuit Court of Appeals in favor of the government concerning the estate tax treatment of life insurance proceeds that are used to fund a corporate redemption obligation under a buy-sell agreement.
- The specific question presented was whether, in determining the fair market value of the corporate shares, there should be any offset to take into account the redemption obligation to the decedent's estate under a buy-sell agreement.
- ***The Supreme Court concluded that there should be no such offset.*** https://www.supremecourt.gov/opinions/23pdf/23-146_i42j.pdf
- In doing so, the Supreme Court resolved a conflict that had existed among the federal circuit courts of appeal on this offset issue.

ArentFox Schiff

The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Facts

- Brothers Michael and Thomas Connelly were the only shareholders in Crown C Supply, Inc. ("Crown"), a closely-held family business that sold roofing and siding materials.
- Michael owned approximately 77% of the company's shares, while Thomas owned approximately 23% of the company's shares.
- The brothers entered into a stock purchase agreement that gave the surviving brother the right to buy the decedent's shares.
- If the surviving brother declined, then Crown (the company) was required to buy back the shares of the first brother to die, and the company bought $3.5 million in life insurance on the life of each brother to ensure it had enough cash to make good on the agreement.

ArentFox Schiff

The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Facts (cont'd)

- The stock purchase agreement provided two mechanisms for determining the price for which Crown would redeem the shares.
  - The principal mechanism required the brothers to execute a new Certificate of Agreed Value at the end of every tax year, which set the price per share by "mutual agreement."
  - If they failed to do so, the brothers were supposed to obtain two or more appraisals of fair market value.
- The brothers never executed a Certificate of Agreed Value or obtained appraisals as required by the stock purchase agreement.

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The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Facts (cont'd)

- Michael died in October 2013, and the company repurchased his shares which constituted an approximately 77% ownership interest in the company for $3MLN.
- The rest of the life insurance proceeds ($500,000) went to fund company operations.
- Michael's estate paid estate taxes on his shares in the company, and the IRS audited and assessed additional estate taxes of nearly $900,000.
- Thomas, as executor of his brother's estate, paid the deficiency and filed a suit in federal district court for the Eastern District of Missouri seeking a refund.

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The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Lower courts

- The district court granted summary judgment in favor of the government, holding:
  - **First**, that Section 2703 of the Internal Revenue Code applied to disregard the buy-sell agreement in determining the value of the decedent's ownership interest in the company for estate tax purposes, and
  - **Second**, that in determining the fair market value of the corporate shares, there should **not** be any offset to take into account the redemption obligation to the decedent's estate under the buy-sell agreement.

ArentFox Schiff

The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Lower courts (cont'd)

- The United States Court of Appeals for the Eight Circuit affirmed.
- This produced a "split between the circuits" on this offset issue.
  - In contrast, the United States Court of Appeals for the Eleventh Circuit in *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005), held that the fair market value of a closely-held corporation did ***not*** include life insurance proceeds on the grounds that the stock purchase agreement created a contractual liability for the company which offset to such extent the life insurance proceeds payable to the company.
  - The primary questions before the Eleventh Circuit in *Estate of Blount* was whether the buy-sell agreement in that case had been substantially modified and therefore was subject to Section 2703. The court's ruling on the impact of the insurance and redemption obligation on the value of the shares lacks any thorough analysis.
  - The court concluded that nonoperating assets such as the life insurance "should not be included in the fair market value of the company, where, as here, there is an enforceable contractual obligation that offsets such assets."

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The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

- The Supreme Court, in a unanimous decision authored by Justice Thomas, resolved this circuit split in favor of the government and affirmed the Eighth Circuit.

Analysis

- As stated by the Supreme Court, the sole question before it was "whether Crown's contractual obligation to redeem [the decedent's] shares at fair market value offsets the value of life insurance proceeds committed to funding that redemption" obligation.
- The Supreme Court concluded that the redemption obligation does **not** provide any such offset.

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The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Analysis (cont'd)

- The Supreme Court explained its reasoning by providing an example that focused on how the per share value of a closely held corporation is generally unaffected by the corporation's redemption obligation under a buy-sell agreement.
- According to the Supreme Court, no willing buyer purchasing the decedent's shares would have treated the redemption obligation as a factor that reduced the value of those shares where the company was required to purchase them for fair market value (a value that included the insurance proceeds).
- It did not matter that the redemption obligation constituted an enforceable obligation under applicable state law – according to the Court, it was not the sort of liability to be given effect for valuation purposes in determining the fair market value of the corporate shares.

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The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Analysis (cont'd)

- The Supreme Court also commented that the adverse estate tax consequences produced here were the consequence of the use of a corporate redemption obligation, and that these adverse estate tax consequences could have been avoided in their entirety had the brothers instead entered into a cross-purchase agreement and funded it with life insurance policies taken out by the brothers on the other brother's lives.
- In a somewhat rare occurrence of commenting upon alternate estate and business succession planning techniques, the Court surmised that such might pose the risk that each brother might fail to pay the premiums for the insurance policy on the other's life, but suggested that such a trade-off may be warranted depending upon the circumstances to prevent the life insurance proceeds payable to the corporation from being included in the decedent's estate without any offset to take into account the corporation's redemption obligation.

The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Observations

- Business appraisers do treat redemption obligations differently than other liabilities of the corporation that are reported on its balance sheet and financial statements.
- At the moment of death, the corporate value has been increased by the right to the life insurance proceeds, but the actual redemption has not yet occurred. Does this raise the question whether it is equivalent to a balance sheet liability?
  - The two arguably are different. A purchaser of the entire company would not have to make the redemption payment, but still would have to pay a balance sheet liability to a third party
  - Did the facts creep into the decisions of the various federal courts in this case? The brothers did not follow the formalities of the agreement and never obtained a formal valuation. The surviving brother, Thomas, and Michael's son in effect struck a deal they wanted, unrelated to what was required by the buy-sell agreement.
- Note that if the redemption obligation did offset the value of the insurance proceeds, Thomas would have ended up with a more valuable asset than he had when Michael died.

The *Connelly* Case (Buy-Sell Agreements and the Supreme Court's Recent Decision)

Observations (cont'd)

- From a tax planning perspective, *Connelly* highlights the relative estate tax benefits that may be derived from instead using a cross-purchase agreement between shareholders or partners to avoid the potential estate tax inefficiency of a corporate redemption agreement.
- In order for a cross-purchase agreement to work where life insurance is involved, the life insurance policies would generally need to be payable to the surviving shareholder (or to a trust or entity structured for the benefit of the surviving shareholder) instead of to the corporation as in *Connelly*.
- That, in turn, is not without some measure of complexity in its own right
  - If there are three or more shareholders, multiple policies on each shareholders life must be purchased
  - Financing of the premium payments can raise additional concerns including for income tax purposes.

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Huffman – option agreement price was less than fair market value, resulting in gift

- *Huffman v. Commissioner*, T.C. Memo 2024-12, is an appropriate companion to the *Connelly* case. As in *Connelly*, the court in *Huffman* found that an agreement among business owners did not control the value of shares of stock for transfer tax purposes, because of Code Section 2703.
- The owners of the corporation, which suppled engineering components to the aerospace industry, entered into several agreements giving shareholder the right to purchase additional shares.
  - The first agreement was between Lloyd Huffman the majority owner of the company, and Robert Barneson. Lloyd assigned his right to acquire Barneson's shares for $2 a share to his son, Chet, who then exercised the right in 1993.
  - Chet then entered into an agreement that gave him the option to purchase additional shares from an entity owned by his mother and Huffman Family Trust for a price not to exceed $3.6 million for the entity and $1.4 million for the Trust.
- Chet exercised the options in 2007 and paid a total of $5 million for the shares, at a time when the IRS asserted the shares had a value of $31.3 million

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Huffman – option agreement price was less than fair market value, resulting in gift

- The court examined the agreement under Section 2703, which requires the value of property to be determined without regard to "any option, agreement or other right to acquire or use property at a price less than the fair market value of the property . . . ." Under Section 2703(b) there is an exception to this rule if the agreement,
  - is a bona fide business arrangement
  - is not a device to transfer property to members of the family for less than full and adequate consideration; and
  - Has terms that are comparable to similar arrangements in arm's length transactions
- The court found that the agreement satisfied the first two prongs of the exception but not the third.
- It rejected the taxpayer's argument that it was similar to the agreement with Barneson. It noted that the taxpayer failed to introduce the full Barneson agreement into evidence, and that the testimony showed that there were substantial differences between the agreements.
- Because the agreement was not binding as to value, the court ruled that the selling parties made a gift to Chet when he exercised the option to purchase the shares.

Final Regulations on Basis Consistency Reporting

- Code Section 1014(f) requires that tax basis of property acquired from a decedent not exceed the value of the property as finally determined for federal estate tax purposes.
- Proposed regulations issued in 2016 created reporting requirements on executors or others required to file an estate tax return to help enforce the basis consistency rule. Estate tax return filers must also file Form 8971 to provide information to the IRS and beneficiaries on the basis of assets the beneficiaries receive. The proposed regulations required the form be filed within 30 days of filing the estate tax return.
- The final regulations, issued September 17, 2024, made several changes favorable to taxpayers.
  - The executor is not required to furnish statements to beneficiaries until they actually acquire the property from the decedent. Treas. Reg. § 1.6035-1(a)(2).
  - The requirement that subsequent transfers also be reported will now only be imposed on trustees of beneficiary trusts and not on all recipients of property. Treas. Reg. § 1.6035-1(h)(1).
  - The regulations also provided greater clarity on when the reporting requirements apply and clarified exclusions for marital or charitable deduction property and tangible personal property. Treas. Reg. § 1.1014-10.

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Final Regulations on GST Tax Relief Provisions

- Section 2642(g)(1), enacted in 2001 directed the IRS to issue regulations setting forth circumstances and procedures for extensions of time for making late GST tax elections, such as the elections to allocate or not to allocate GST exemption.
- The IRS issued Notice 2001-50, which directed that taxpayers may use the general procedures for seeking relief for errant regulatory elections contained in Treas. Reg. § 301.9100-3.
  - Under those relief procedures, a taxpayer may request relief by private letter ruling. In general, relief will be granted if the taxpayer can show that he or she acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the government.
  - The IRS has been generous in granting relief. There was concern that taxpayers were gaming the system, for example, by allowing the statute of limitations on a gift tax return to expire before seeking relief for a missed election to allocate GST exemption.
- In 2008, the IRS issued proposed regulations under new Treas. Reg. § 26.2642-7 to give the IRS more leeway in denying relief.
- The IRS issued final regulations on May 6, 2024.

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Final Regulations on GST Tax Relief Provisions

- The final regulations continue to apply the general standard for 9100 relief.
  - §26.2642-7(d)(3) of the final regulations provides that "[r]equests for relief … will be granted when and to the extent that the transferor or the executor of the transferor's estate provides evidence (including the affidavits described in paragraph (i) of this section) establishing to the satisfaction of the IRS that the transferor or the executor of the transferor's estate acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the government."
  - The final regulations adopt the nonexclusive list of circumstances that the IRS will consider in determining whether taxpayers acted reasonably and in good faith to qualify for relief. In evaluating whether relief will prejudice the interests of the government, the regulations provide that IRS will consider whether the taxpayer is attempting to benefit from hindsight in making the request for relief, whether the taxpayer sought to delay the request to deprive the IRS of sufficient time to challenge the nature of the property claimed, and whether there were intervening circumstances.
  - The taxpayer affidavit needs to be very specific on how the oversight or mistake was found and the steps taken to correct it.
- The final regulations make clear that relief may be obtained to correct or amend or revoke an earlier allocation or election, not just make a late allocation or election. This is new, and welcome.

The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- We now have Final Regulations governing required minimum distributions (RMDs) that were issued in July 2024 (together with additional proposed regulations).
- As a result of the Final Regulations, among other things:
  1) Where the 10-year rule applies to RMDs, they must start in 2025 and no catch-up is needed for years prior to 2025.
  2) If the IRA is paid into the revocable trust upon death, the trust must mandate how the IRA is then divided.
     - As an alternative approach that is easier to administer, pay over the IRA to separate trusts instead

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The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- ***To set the stage here*** -- in December 2019, Congress passed the Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act").
- The SECURE Act introduced a new "***10-year rule***" that applies to distributions to certain beneficiaries who are considered "designated beneficiaries" of Qualified Plan participants and IRA owners who have died (collectively "participants").
- As a term of art under the SECURE Act, "designated beneficiaries" are to be contrasted with "eligible designated beneficiaries" – who continue to get the benefit of a life expectancy payout under the SECURE Act.

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The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

– The classes of persons who may be considered “eligible designated beneficiaries” under the SECURE Act are very limited, however, and are confined to the following:

(i) the participant’s surviving spouse;

(ii) the participant’s child who is under the age of 21 (note that the 10-year rule would spring into play once the child attains age 21);

(iii) a disabled individual;

(iv) a chronically ill individual; and

(v) an individual who is not more than 10 years younger than the participant.

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The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- The SECURE Act's language led most practitioners to believe that designated beneficiaries of participants who have died would not be obligated to take any annual RMDs from Qualified Plans and IRAs until at least 10 years after the participant's death.
  - This belief stemmed from the fact that the language of the SECURE Act that introduced the 10-year rule referenced the methodology for making distributions that are subject to the "5-year rule" that applies in the case of participants who have died prior to their "required beginning date" (which is generally now age 73, subject to certain exceptions) without having named a designated beneficiary.
  - Under the 5-year rule, no annual RMDs are required to be made prior to the end of the 5 year period.

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The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- It therefore came as quite a jolt to the estate planning community when the IRS, in proposed regulations issued in February 2022, took the position that designated beneficiaries of participants who died subsequent to the "required beginning date" need to take annual RMDs each year under the 10-year rule.
- The IRS's position precipitated the submission of numerous comment letters to the U.S. Department of Treasury by various groups and interested parties throughout the country.
  - These comment letters challenged the correctness of the IRS's interpretation of the SECURE Act in this respect, and in several instances requested *transition relief* to prevent the imposition of a 50% excise tax on designated beneficiaries that are subject to the 10-year rule who fail to take their RMDs due to the IRS's surprising construction of the 10-year rule in its proposed regulations.

The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- Fortunately, the IRS issued **Notice 2022-53**, in which it yielded to the estate planning community's request for transition relief while it continues to review how to address this issue (and others) in final regulations.
- The IRS has done this by waiving the 50% (now 25%) excise tax that would otherwise be imposed under Section 4974(a) of the Internal Revenue Code on beneficiaries for any shortfall in the amount of the RMD during 2021 or 2022 in either of the following two circumstances:
  1. Where the RMD is to be made to a designated beneficiary of a participant if: (1) the participant died in 2020 or 2021 and on or after the participant's required beginning date, and (2) the designated beneficiary is not taking lifetime or life expectancy payments (due, for example, to such person also being an "eligible designated beneficiary"); or
  2. Where the RMD is to be made to a beneficiary of an eligible designated beneficiary if (1) the eligible designated beneficiary died in 2020 or 2021, and (2) that eligible designated beneficiary was taking lifetime or life expectancy payments pursuant to certain relevant provisions of the Internal Revenue Code.

The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- In ***Notice 2023-54***, the IRS pushed back the proposed effective date even further, stating that "Final regulations regarding RMDs under Section 401(a)(9) and related provisions will apply for calendar years beginning no earlier than 2024."
  - Notice 2023-54 also provides that the IRS will not assert the Section 4974 penalty for RMDs not made in 2023 where the ten-year payout rule applies.

The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- Notice 2023-54 also provided guidance related to the change in the required beginning date of RMDs made under the SECURE 2.0 Act of 2022.
  - The SECURE 2.0 Act increased the required beginning date age to 73 for those who turn 72 after 2022 and to 75 for those who turn 74 after 2032.

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The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- In *Notice 2024-35*, the IRS pushed back the proposed effective date even further, stating that final regulations regarding RMDs under Section 401(a)(9) and related provisions are anticipated to apply for calendar years beginning on or after January 1, 2025.
  - Notice 2024-35 also provides that the IRS will not assert the Section 4974 penalty for RMDs not made in 2024 where the ten-year payout rule applies.

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The latest on planning with retirement benefits under the SECURE Act and the SECURE 2.0 Act

- This transition relief only applies where the 10-year rule comes into play in the case of a person who dies after his or her required beginning date – very importantly, it does **not** provide an automatic waiver from excise taxes for failure to take a RMD in any other circumstances, such as in the case of an eligible designated beneficiary who is still living (as to whom no such ambiguity was presented concerning the need to take annual RMDs each year).
- But these Notices provide much needed transition relief for the years 2021, 2022, 2023 and 2024.
- **We now have final regulations governing RMDs that were issued in July 2024 (together with additional proposed regulations).**

ArentFox Schiff

Business Succession Planning – Use of Purpose Trusts and Section 501(c)(4) Organizations

– Business succession planning was an area of focus at Heckerling, with sessions on Purpose Trusts and 501(c)(4) organizations, key factors for young professionals to know to become successful advisors to business owners, tax issues when partners die, and buy-sell agreements

– Business owners who want to have their business used to support social and charitable causes should consider the use of Purpose Trusts and 501(c)(4) organizations.

– The owner of Patagonia put the use of 501(c)(4) organizations on the map by giving the majority of company stock to one, with voting control gifted to a separate perpetual GST trust.

– A Purpose Trust is a trust without ascertainable beneficiaries. Instead the trust serves a purpose, such as operating a business.

– Purpose Trusts are authorized in most states now, and the UTC recognizes them. Oregon has a very detailed and helpful statute.

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Business Succession Planning – Use of Purpose Trusts and Section 501(c)(4) Organizations

- The best structure will depend on the current ownership, the owners' goals, and financial characteristics of the business. Almost always needs to be a mature, self-sustaining business

- Founding owner creates and funds purpose trust, which uses assets and debt to buy out minority owners. Funds accumulated in trust and debt eventually used to buy out founding owner

- Purpose trust acquires controlling voting stock, and outside investors who receive non-voting preferred stock interests buy out family owners

- Donation of stock to a 501(c)(4) (such gifts are nontaxable under section 2501(a)(6)) or it also buys some stock with a note.

- Purpose Trust owns only the brand, and licenses it to third party owner/franchisees with strict controls

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Business Succession Planning – Use of Purpose Trusts and Section 501(c)(4) Organizations

- This is a new area with many complexities; careful planning and financial modeling is required
- If primary owner retains voting control, beware of the possible application of Section 2036. In a 501(c)(4), gifts during life are nontaxable, but a transfer at death is fully taxable.
- It's not entirely clear whether a Purpose Trust is a trust for income tax purposes or should be taxed as a corporation
- Significant work needs to go into defining mission and the founder's vision, and stewardship of it

Portability and Use of Both Spouses' Exemptions

- Clary Redd presented on use of both estate tax exclusions during life and at death, with important reminders about the role of portability and planning options with Clayton QTIP Trusts
- The session promoted the use of portability instead of relying on traditional marital formulas where the combined wealth is less than two times the exclusion and likely to remain there
- Estate of Clayton v. Comm'r, 976 F.2d 1486 (5th Cir. 1992), approved the use of a QTIP with provisions that allow the non-elected portion to be transferred to another trust. IRS has conceded this point and approved it by regulation.
    - This creates tremendous flexibility and enables attorneys to put off the decision on use of the exclusion or reliance on portability until the first death
    - In larger estates, reliance on a QTIP trust means attorneys should consider how to make it flexible enough to allow the surviving spouse to do further planning

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Expanded Use of No-Contest Clauses

- Both the Recent Developments panel and the session on Fiduciary Litigation discussed several recent no-contest clause cases that involved attempted expanded use of this planning option
- Jacks v. Brossett, 2024 Ark. App. 6 (2024) – beneficiary forfeited interest in trust by challenging the appointment of a trustee. 4 dissenting judges said challenging a fiduciary's appointment, or seeking judicial enforcement of fiduciary duties, cannot justify invoking no-contest clause.
- Spurlock v. Wyoming Trust Co., 2024 Wy. 19, 542 P.3d 1071 (2024) – court ruled that "a lawsuit to remove a trustee for cause does not constitute a challenge to a trust" on public policy grounds
- Compare In re Estate of Buder, 658 S.W.3d 168 (Mo. Ct. App. 2022), holding that seeking an accounting would not trigger an in terrorem provision in a trust, but seeking removal of the trustee would
- In re Estate of McLoughlin, No. 23-P-770 (Mass. App. Ct. 2024), providing an affidavit as a witness in a sibling's contest action does not trigger a no-contest clause against the affiant

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Miscellaneous Items

- Paul Lee spoke on the impact of death on the basis of partnership interests and partnership assets. Among other things:

  (1) in a wholly disregarded LLC at death, even if multi-member (grantor trust and decedent), the step up in basis at death is actually a direct step up in basis of each asset.

  (2) there are nuances to how inside and outside basis is impacted at death of partner/member

- Farhad Aghdami spoke on estate and tax planning for real estate investors, and Gray Edmondson joined Farhad in an excellent break-out session

  (1) Watch out for transfers where debt is in excess of basis where the transfer is not to a grantor trust

  (2) Beware special rules that apply to transfers of interests in qualified opportunity zone (QOZ) funds where the transfer is not to a grantor trust

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Questions?

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