FPA DFW Chapter Meeting
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Estate Planning Current Developments

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Presentation Outline

I. Current wealth transfer landscape
II. Looking back
III. Recent changes to Internal Revenue Code and Treasury Regulations and relevant administrative guidance
IV. Case law update
V. Looking forward and providing value to our clients

Current Wealth Transfer Landscape

- Current Transfer Tax Exemptions and Exclusions:
  - ❖ The gift, estate, and generation-skipping transfer tax exclusion amount for 2023 is $12,920,000 or $25,840,000 for married couples (*see* Rev. Proc. 2022-38).
  - ❖ The gift tax annual exclusion is $17,000 for 2023.
  - ❖ The gift, estate, and generation-skipping transfer tax exclusion will revert (or, “sunset” under the terms of the TCJA) to $5,000,000 (indexed for inflation) on January 1, 2026.
- Anti-Clawback authority applicable to lifetime gifts utilizing “doubled exemption” (relevant Regulations discussed infra).
- Large valuation discounts available under support from Tax Court and 5th Circuit cases.

Current Wealth Transfer Landscape

- Historically low AFRs (to facilitate family transfers) are rapidly increasing
  - ❖ Sub-1.0% for all of April 2020–March 2022, but 4.3% in May 2023
  - ❖ 2011–19: 1.0–4.0%
    - ➢ November 2017: 2.4%
    - ➢ November 2012: 1.0%
  - ❖ 2002–10: 2.0–6.0%
    - ➢ November 2007: 5.2%
  - ❖ 1989–01: 6.0%–11.0%
- Apparent failure of onslaught of 2021 legislative proposal including those related to GRATs and grantor trusts, which continue to be supported by authority.

Summary of 2021 Failed Proposals: House Ways and Means Committee Proposal

- Reduction of gift and estate (and GST) tax exemption to 2017 levels of $5,000,000 per person (indexed for inflation).
- Disallowance of valuation discounts for nonbusiness assets.
- Related to grantor trusts:
  - ❖ Proposed new I.R.C. § 2901
    - ➢ Inclusion in gross estate of grantor,
    - ➢ Distributions treated as gift,
    - ➢ Termination of grantor trust status considered gift, and
    - ➢ Adjustments for prior gifts.
  - ❖ Proposed new I.R.C. § 1062
    - ➢ Sale to deemed owner treated as third-party transaction (therefore, recognition of gain), and
    - ➢ Effective Date adjustments.

Summary of 2021 Failed Proposals: House Ways and Means Committee Proposal

- Tax Rate and Bracket Increases:
  - ❖ Return individual top marginal income tax rate to 39.6% and reduce top income tax brackets (in turn, increasing effective rates).
  - ❖ Top capital gain rate increased from 20% to 25%.
  - ❖ 3% income tax surcharge on individuals for modified gross income over $5,000,000 and on trusts and estates for modified gross income over $100,000.
  - ❖ Modify corporate tax rate from the current 21% to the following brackets and rates:
    - ➢ 18% on income up to $400,000,
    - ➢ 21% on income up to $5,000,000, and
    - ➢ 26.5% on income over $5,000,000, with graduated rates phasing out for corporations earning more than $10,000,000.

Summary of 2021 Failed Proposals: House Ways and Means Committee Proposal

- Regarding qualified/retirement accounts:
  - ❖ Prohibit Roth IRA conversions for AGIs over $450,000 for married filing joint or $400,000 for singles.
  - ❖ Prohibit contributions to retirement accounts if the total value of all defined contribution accounts and IRAs is more than $10,000,000 and if AGI is over $450,000 for married filing joint or $400,000 for singles (excluding SEP and SIMPLE IRAs).
  - ❖ 50% required distribution from Roth accounts of excess over $10,000,000 and 100% of excess over $20,000,000.

Summary of 2021 Failed Proposals: Senator Bernie Sanders's Proposal

- Specific to gift and estate tax issues:
  - ❖ Reduce lifetime exemption limits
    - ➢ Estate: $3,500,000 [NOTE: this was the 2009 exemption]
    - ➢ Gift: $1,000,000
  - ❖ Progressive increase of estate tax rate to 65% and removal inflation adjustment.
  - ❖ Grantor trusts included in grantor's gross estate.
  - ❖ GRAT terms and value limitations.
  - ❖ Disallowance of valuation discounts for nonbusiness assets.
  - ❖ Imposition of new 50 year rule against perpetuities (*i.e.*, term limit for trusts) for GST purposes.

Legislative Expectations

- (Significant) Tax legislation unlikely under current congressional landscape; expect very little.
- Congress wishes to crackdown on advanced wealth transfer techniques.
- Will the doubled exemption amount sunset in 202? May depend on who is in control of congress. Could we see a compromise?

2023 Greenbook
Estate and Gift Tax Related Provisions

- Issued by Treasury in March 2023
- General explanations of the Biden Administration’s fiscal year 2024 revenue, tax, and budgetary priorities and items under consideration for the coming year.
- Covers all tax related matters.

2023 Greenbook
Estate and Gift Tax Related Provisions

- A (no exhaustive) list of matters specifically addressed in the 2023 Greenbook:
  - ❖ Grantor trust limitations (eliminating “zeroed-out” GRATs and imposition of 10-year minimum term),
  - ❖ Limits on annual exclusion gifts,
  - ❖ Limit duration of GST exempt trusts and generational application,
  - ❖ Raise corporate tax rate,
  - ❖ Increase top marginal income tax rate for high earners (MFJ: $450,000),
  - ❖ Impose minimum income tax on taxpayers with net worth in excess of $100MM,
  - ❖ Capital gain reforms,
  - ❖ Gifts during life and at death would be a taxable/recognition event for federal income tax purposes.
- Why does this matter?
  - ❖ Largely consistent with prior iterations and shows attention to certain wealth transfer planning techniques.

SECURE Act

- Effective January 1, 2020
- Notable changes to prior laws applicable to qualified accounts I.R.C. § 401(a):
  - ❖ Raised Required Beginning Date (“RBD”) to age 72;
  - ❖ Limited payouts to Designated Beneficiaries (“DB”) to 10 years, except for “Eligible Designated Beneficiaries” (“EDBs”); and
  - ❖ Introduced and defined EDB as:
    - ➢ Surviving Spouse,
    - ➢ Child under the age of majority,
    - ➢ Beneficiary not more than 10 years younger,
    - ➢ Disabled or chronically ill, and
    - ➢ Certain See-Through Trusts.
- Unchanged: rules for Non-Designated Beneficiaries such as estates and charities (5 years).

SECURE Act
Beneficiary Categories

Designated Beneficiary	**Eligible Designated Beneficiary**	**Non-Designated Beneficiary**
Any individual (or certain trusts) named on beneficiary designation form or, as of Sept. 30 of year following death, determined to be beneficiary under terms of plan.	1. Surviving spouse of participant 2. Child of participant who has not reached age of majority (21 years of age) 3. An individual who is not more than 10 years younger than participant 4. Disabled or chronically ill beneficiary 5. Certain Trusts	Any beneficiary that is not designated, or a DB or EDB. Most often trusts that do not qualify as see-through trusts, estates, or charities.

SECURE Act Proposed Regulations

- Introduced February 24, 2022
- Contains many important definitional clarifications, including:
  - ❖ Minor: Individual reaches the age of majority at 21, regardless of the definition under state law. (Prop. Treas. Reg. § 1.401(a)(9)-4(e)(3))
  - ❖ NMTTYY: Regulations clarify that "not more than 10 years younger" than the participant must be calculated to the birthdates, not birth years. (Prop. Treas. Reg. § 1.401(a)(9)- 4(e)(6))
  - ❖ Beneficiary Finalization Date: Instructs how to determine who is/are the participant's identifiable beneficiary(ies). (Prop. Treas. Reg. § 1.401(a)(9)-4)
  - ❖ Chronically ill / Disabled beneficiary (EDB to stretch distributions): must be disabled (within the meaning of I.R.C. § 72(m)(7)) or chronically ill as of participant's death or deemed disabled by the Social Security Administration as of participant's death. (Prop. Treas. Reg. § 1.401(a)(9)-4(e)(4))
  - ❖ ALAR: Regulations appear to maintain the "at least as rapidly" rules. (Prop. Treas. Reg. § 1.401(a)(9)-5(d))
  - ❖ Several clarifications applicable to See-Through trust drafting.

SECURE Act Proposed Regulation Distribution Options

General summary of the Proposed Regulation distribution schedule by type of beneficiary:

	Participant Died Before RBD	**Participant Died On or After RBD***
Designated Beneficiary	10 year rule, *with no RMDs*	RMDs based on the greater of beneficiary's life expectancy or participant's life expectancy, with balance taken by 10th anniversary of participant's death, or (2) the final year of the beneficiary's life expectancy.
Eligible Designated Beneficiary	Beneficiary's life expectancy (or 10 year rule, *with no RMDs)*	RMDs based on beneficiary's life expectancy, *then 10 year rule at beneficiary's death or when ceases to be EDB*
Non-Designated Beneficiary	5 year rule, *with no RMDs*	RMDs based on participant's (decedent) life expectancy from year of death

** Remember that the year of death RMD must be taken by the beneficiary if not taken by the participant!*

Relief for Missed 2021 or 2022 RMDs

- IRS Notice 2022-53 issued October 7, 2022
  - ❖ Application limited to 2021 and 2022 "specified" Required Minimum Distributions ("RMDs")," which are those that would have been required for 2021 or 2022 under the proposed regulations' interpretation of I.R.C. § 401(a)(9)(H).
  - ❖ Effect of waiving the 50% excise penalty for failure to take RMDs if:
    - ➢ A 2021 and/or 2022 RMD, was not taken under new 10-year payout scheme, and
    - ➢ Participant died in 2020 or 2021 on or after RBD.
  - ❖ Thus, Final Regulations for RMDs under I.R.C. § 401(a)(9) will be effective *no earlier than* the 2023 distribution year.

Planning Under SECURE and Proposed Regulations: Charitable Planning and CRTs

- Retirement plans have always been a good choice for charitable planning because distributions paid directly to charity can (largely) avoid tax.
- With the elimination of the beneficiary "stretch" in many cases, benefits associated with qualified plan charitable gifting, either outright or by utilizing charitable remainder trusts ("CRTs"), become more noteworthy.
- CRTs *can* provide an effective "work around" to regain *a portion* of the term of the historic stretch distribution scheme.
- *BUT* … CRTs are ***NOT*** an exact stretch equivalent! Contrary to popular belief, these are rarely superior from a wealth transfer perspective.

Planning Under SECURE and Proposed Regulations: Charitable Planning and CRTs

- A few critical CRUT rules (*see* I.R.C. § 664(d)(2)):
  - Future value of charitable remaining must be at least 10% of the value of the trust at inception.
  - Unitrusts can last for up to 20 years.
    - *NOTE*: CRUTs are gain only 10 years as compared to a DB distribution term.
  - Unitrusts must pay 5%–50% annually to beneficiaries.
    - *But compare*: a hypothetical 35 year old beneficiary:
      - RMD under the old stretch rules would have been about 2% of the account balance at age 35.
      - A 5% RMD would not have been applicable for almost 30 years! And, a larger RMD typically means a larger income tax liability.
  - I.R.C. § 7520 rate is used to calculate actuarial value of remainder.

Planning Under SECURE and Proposed Regulations: Roth IRAs

- RMD rules also apply to Roth 401(k) accounts but not to Roth IRAs while the participant is alive.
- Because Roth IRAs have no RMDs during owner's life, the owner is deemed to have died *before* RBD regardless of the Roth IRA owner's age at death; meaning, for a DB, the 10-year rule will apply *without* RMDs.
- Potential Traditional-to-Roth conversions garnering increased consideration.

Planning Under SECURE and Proposed Regulations: Estate Planning and Administration

- Named beneficiary options:
  - ❖ Spouse,
  - ❖ EDBs or DBs, outright,
  - ❖ Trust for EDB, or
  - ❖ Trust for DBs (provided it qualifies as See-Through trust).
- Year of death RMD
  - ❖ If participant dies on or after RBD without taking full RMD in year of death, then year of death RMD must be distributed to the beneficiary by 12/31 of year of participant's death.
- Exercise caution when distributing balance of account to Estate.

SECURE Act 2.0

- Signed into law December 29, 2022 as part of the 2023 Consolidated Appropriations Act.
    - ❖ A collection of several separate House and Senate proposals.
    - ❖ Picks up where SECURE left off in terms of further expanding access to workplace retirement plans.
    - ❖ Intended to encourage sound savings and retirement preparation habits.

SECURE Act 2.0

- Key provisions:
  - ❖ RBD increase from 72 to 73 as of January 1, 2023 and to 75 as of January 1, 2033.
  - ❖ Opt-out Enrollment.
  - ❖ Expanded Access for Part-Time Workers. Currently either one year of service/1,000 hours worked or three consecutive years of service/500 hours of service, in 2025, requirement will be either one year/1,000 hours or two years/500 hours.
  - ❖ Student Loan Repayment Match.
  - ❖ Penalty Reduction. The excise tax for failing to take RMDs will be reduced from 50% to 25% and further reduced to 10% if timely corrected.
  - ❖ Account Lost & Found national databased created by DOL.

SECURE Act 2.0

- Key provisions, specific to Roth accounts:
  - ❖ Roth Catch-up required for all employees with compensation over $145,000.
  - ❖ Elimination of Roth 401(k) RMDs, consistent with the distribution rules for Roth IRAs.
  - ❖ Roth Employer Match now allowed.
  - ❖ SIMPLE and SEP Roth. SIMPLE IRAs and SEPs may now accept contributions on a Roth basis.
  - ❖ 529 to Roth Rollover. Unused § 529 college savings plan can now be rolled over on a tax- and penalty-free basis to a Roth IRA subject to conditions including, but not limited to, a $35,000 lifetime maximum rollover amount, application of standard annual IRA contribution limits, and the 529 account must have been in existence for at least 15 years.

“Anti-Clawback” Regulations

- Final Regulations issued November 26, 2019 (Treas. Reg. § 20.2010-1(c))
- Background:
  - ❖ In 2026, the current doubled exemption is estimated to revert to $6,800,000 (estimated value of $5,000,000 as statutorily indexed for inflation), or “sunset” by the terms of the legislation.
- Objective:
  - ❖ Created a special rule to preserve credit (Basic Exclusion Amount) used on lifetime gifts, to the extent it exceeds the credit available at death.
  - ❖ In other words, “use it or (*you may*) lose it.”

“Anti Abuse” Proposed Regulations to “Anti-Clawback” Regulations

- Proposed Regulations published April 27, 2022 (Prop. Treas. Reg. § 20.2010-1(c)(3))
- Objective:
  - ❖ Limit application of the Anti-Clawback Regulations in certain situations, preserving the Service’s potential clawback in certain situations.
- Effect:
  - ❖ Fairly complicated anti-abuse provisions that, in short, recapture the use of the *temporarily doubled* gift, estate, and GST tax exclusions at death, disallowing transfers that utilized the doubled exemption when interest, control, or ownership therein was retained by the donor.

“Anti Abuse” Proposed Regulations to “Anti-Clawback” Regulations

- Potentially affected/targeted transfers include:
  - ❖ Enforceable (unsatisfied) promises to pay/make gift;
  - ❖ QTIP disclaimers;
  - ❖ Transfers typically includible under I.R.C. §§ 2035, 2036, 2037, 2038, or 2042;
  - ❖ Grantor Retained Income/Interest Trusts (“GRITs”);
  - ❖ Transfers of certain applicable retained interests in corporations or partnerships under I.R.C. § 2701 or trusts under I.R.C. § 2702, which may include:
    - ➢ Intra-family transfers of entity interests when the senior generation retains (some or all) preferred rights, and
    - ➢ Certain GRAT and QPRT transfers; and
  - ❖ Targeted transactions involving relinquishment of interest within 18-months of the decedent’s death (*but see* exceptions to exception).

No Inclusion = No Basis Adjustment ,

- Irrevocable grantor trust not included in deceased grantor's gross estate receives no basis adjustment at death.
- In Rev. Rul. 2023-2, 2023-16 IRB (Apr. 17, 2023), the IRS stated that the basis adjustment under I.R.C. § 1014(a) does not apply to the assets of an irrevocable grantor trust that are not included in the grantor's gross estate for federal estate tax purposes.
  - ❖ Because assets of a grantor trust in this situation are not "***acquired or passed from a decedent by bequest, devise, inheritance, or otherwise***" within the meaning of I.R.C. § 1014(b), and, therefore, I.R.C. § 1014(a) does not apply.
  - ❖ The basis of the asset immediately after the grantor's death is the same as the basis of asset immediately prior to the grantor's death.

Extension of Portability

- Rev. Proc. 2022-32 (superseding Rev. Proc. 2017-34) issued July 8, 2022
- Extension of time to elect portability related to deceased spouse's unused exclusion ("DSUE") amount under I.R.C. § 2010(c)(5)(A)
  - ❖ Prior Rule: Under Rev. Proc. 2017-34, if the estate was not required to file estate tax return (under I.R.C. § 6018(a)), an estate could elect portability (late) until the **second anniversary** of the decedent's date of death (9 months longer than the extended Form 706 deadline).
  - ❖ New Rule: If the estate was not required to file an estate tax return under I.R.C. § 6018(a), an estate may elect portability (late) until the **fifth anniversary** of the decedent's date of death.
- To obtain relief under Rev. Proc. 2022-32, file a Form 706 and, thereon, indicate "FILED PURSUANT TO REVENUE PROCEDURE 2022-32 TO ELECT PORTABILITY UNDER I.R.C. § 2010(c)(5)(A)".

Proposed Regulations on Estate Tax Deductions

- Issued on June 28, 2022
  - ❖ Addresses administration expenses, claims against estates, interest expense on amounts owed by estates under I.R.C. § 2053.
  - ❖ Public hearing held on October 12, 2022.
  - ❖ Likely to be applicable to estates of decedents dying after *final* publication.
- Specific focus on rules applying present-value principles to certain long-term obligations of estates (both contingent and noncontingent expenses and claims).
  - ❖ Guidance addresses limitation on present-value deductibility of future contingent recurring obligations.
  - ❖ Similar Regulations were proposed in 2007 but garnered significant criticism for potentially producing inequitable results and, therefore, were removed from 2009 final Regulations.

Proposed Regulations on Estate Tax Deductions

- Provides guidance and (*some*) clarity regarding:
  - Use of present-value principles in determining the estate deduction values for funeral and administration expenses
    - Three-year "grace period" from decedent's date of death for ordinary administrative expenses before present-value calculation is required.
    - For a deductible claim or expense (per I.R.C. § 2053(a) and Treas. Reg. § 20.2053-1(a)) to be paid after the third anniversary of the decedent's date of death, deductible amount to be discounted by the AFR (midterm or long-term, as applicable, under I.R.C. § 1274(d) for the month of decedent's death, compounded annually);
  - Deductibility of interest expense accruing on tax and penalties owed by an estate and on certain loan obligations incurred by an estate;
  - Requirements for substantiating the value of a claim against an estate that's deductible in certain cases; and
  - Deductibility of amounts paid under personal guarantees of decedents.

Amended Texas Property Code § 112.036

- According to the "Rule Against Perpetuities" ("RAP"), non-charitable Texas trusts may not last forever.
- Old Rule
  - ❖ Trusts were required to vest, "not later than 21 years after some life in being at the time of creation of the interest, plus a period of gestation."
  - ❖ Practical approximate vesting period was 130 years.
- New Rule, effective September 1, 2021
  - ❖ "An interest in a trust must vest, if at all, … not later than 300 years after the effective date of the trust, if the effective date of the trust is on or after September 1, 2021; … ."
  - ❖ The Texas RAP vesting period is now approximately 300 years.
- ***If the trust provisions recite the old RAP, the shorter period applies!***

Corporate Transparency Act

- The Corporate Transparency Act ("CTA") will require small, privately-owned companies to report their ultimate individual owners to the federal government.
- Many estate plans include companies and entities that will be subject to CTA.
- In general, the CTA requires that the "reporting company" file with FinCEN (Financial Crimes Enforcement Network of the Department of Treasury) a report that identifies each "beneficial owner" of the reporting company and the "applicant" of the reporting company. The following information is required for these persons: full legal name, date of birth, current address and unique identifying number (i.e., passport, drivers license).
- In addition, the reporting company is required to file updated reports with FinCEN within 1 year after there is a change in the information previously provided to FinCEN by the reporting company. Regulations will be needed to further clarify this requirement.
- CTA includes penalties for willfully providing false or fraudulent information or willfully failing to report or update information or knowingly disclosing information. The penalties are both civil and criminal.

Inflation Reduction Act

- Budget reconciliation bill sponsored by Schumer (D-NY) and Manchin (D-WV), passed along strict party lines, and signed into law on August 16, 2022.
- Largely inapplicable to wealth transfer matters except as it relates to the an $80B investment in IRS enforcement over the next 10 years but, of course, it is unclear how the funding will be allocated.
- Primarily addresses the following:
  - ❖ Clean energy production, energy cost reduction, and climate change,
  - ❖ Corporate minimum tax (15% applicable to corporations with $1B in income),
  - ❖ Surcharge on stock buybacks,
  - ❖ Prescription drug pricing reform and ACA-related extension and reduction of premiums, and
  - ❖ Carried interest taxation modifications and clarifications.

Case Update

Sorensen v. Comm'r,

T.C. Docket 24797-18, 24798-18, 20284-19 and 20285-19

- Two cases settled by a stipulated decision on August 22, 2022.
- Relevant Facts:
  - ❖ The donors relinquished dominion and control of the 9,385 shares (approx. 30% of each brother's nonvoting interests) for $532.79 per share on December 31, 2014 (not a formula amount?) and sold another 5,365 nonvoting shares for a $2,858,418 promissory note (using the same appraisal) (not defined value transfers) on March 31, 2015.
  - ❖ Firehouse Restaurant Group, Inc. sold for almost $1B on November 15, 2021. Each trust received about $150 million.
- Issues: Are *Wandry* clauses respected? What was the appropriate FMV of the shares on the various transfer dates (could the same appraisal be utilized)? Were penalties reasonable?
- Outcome: IRS win (maybe). Formula clause did not apply; 10% accuracy penalty apply to 2015 transfer; gift tax paid. Although the case settled without trial, it provides notable lessons.
- Takeaway: Valuation was central to the case but it's also an example of how a *Wandry* clause could be otherwise interpreted by the Service and provides the IRS's arguments regarding such clauses and how terms can be distinguished from *Wandry*.

Case Update

Smaldino v. Comm'r, T.C. Memo 2021-127 (Nov. 10, 2021)

- Relevant Facts: Husband owned an LLC and desired to transfer an interest in the LLC to a Trust for his children from a prior marriage.
  - ❖ Husband first gifted to Wife that number of LLC units equal in value to $5,200,000.
  - ❖ Wife then gifted those same units to the Trust for Husband's children.
  - ❖ Husband then gifted additional units to the Trust, equal in value to $1,000,000.
- Issue: The IRS alleged that the members disregarded corporate formalities and governance and the entire transaction was part of a prearranged plan constructed solely for tax purposes.
- Outcome: IRS win. Tax Court collapsed the transaction, ignoring Husband's gift to Wife and treating the entire gift as made by Husband, resulting in a gift tax liability because Husband had insufficient remaining lifetime exemption to cover the entire gift.
- Takeaway: Respect for corporate formalities cannot be overlooked as IRS seems willing to question the documents used in planning transactions.

Case Update

Nelson v. Comm'r, 17 F.4th 556 (5th Cir., Nov. 3, 2021)

- Relevant Facts: Mrs. Nelson desired "to make a gift and to assign to [the Trust] her right, title and interest in a limited partner interest having a fair market value of [$2,096,000.00] as of December 31, 2008, as determined by a qualified appraiser within [90] days of the effective date of [the] Assignment."
- Issue: Gift and sale of LP interest to SLAT using defined value clause as in, "having a FMV on [X] date, as determined by a qualified appraiser within [X] days." The IRS challenged valuations and proposed gift tax deficiencies due to the formula language.
- Outcome: IRS win. The Court held the Taxpayers to the value determined by the appraiser, not the value as "finally determined" for tax purposes. The Court essentially approved the use of formulas (as well as tiered discounts, for that matter).
- Takeaway: Recognize the types of formula clause language, including defined value, Wandry, and King; the IRS will enforce what is written!

Case Update

Estate of Moore v. Comm'r, T.C. Memo 2020-40 (April 7, 2020)

- Relevant Facts: Taxpayer began negotiations sale of his farm, but experienced a health event, followed by hospice care. Within 3 months, Taxpayer settled a series of trusts, forms FLP, finalizes farm sale, sells FLP to dynasty trusts, settles expenses, and dies. But, Taxpayer sold the farm within days of forming FLP with no FLP involvement despite 80% ownership. FLP paid for attorney fees for Taxpayer estate planning and made a series of loans to Taxpayer and his kids, none of which were ever repaid. Taxpayer continued to live on and manage farm until death.
- Issue: Continued use and enjoyment of transferred assets and question as to non-tax purpose of sale of FLP interests.
- Outcome: IRS win. Inclusion in Taxpayer's gross estate under I.R.C. § 2036.
- Takeaway: There are several but, complex "death-bed" transfers can cast unwanted light on planning, retaining enjoyment of transferred assets is detrimental, non-tax purposes for planning can prove critical, and one must observe and respect formalities of plan.

Case Update

Estate of Levine v. Comm'r, 158 T.C. No. 2 (Feb. 28, 2022)

- Relevant Facts: Decedent's trust paid premiums for daughter's and son-in-law's life insurance policies owned by ILIT, with right to be repaid under a split-dollar insurance arrangement.
- Issue: The IRS questioned the value includible in decedent's estate: (1) the right to receive repayment for policy premiums (≈$2,200,000), or (2) the policy cash surrender value as of decedent's date of death (≈$6,000,000).
- Outcome: Taxpayer win. Decedent had only an unrestricted right to receivable of premium, not a right to revoke or terminate the policies or ILIT; thus, the cash surrender value was appropriate value for estate tax reporting purposes.
- Takeaway: Careful planning when employing split-dollar insurance and trust arrangements is critical, considering state law applicable to trusts and the regulatory regimes related to includability and valuation of split-dollar arrangements.

Case Update

Estate of Morrissette v. Comm'r, T.C. Memo 2021-60 (May 13, 2021)

- Relevant Facts: Another split-dollar case involving dynasty trusts. Payment of premiums were reported as gifts for gift tax purposes under I.R.C. § 1.61-22.
- Issue: Whether I.R.C. §§ 2036 or 2038 apply to recapture lifetime transfers made related to split-dollar arrangements and, if so, what is the value of inclusion in the gross estate. If not, whether I.R.C. § 2703 special valuation rules apply to disregard unilateral termination restrictions.
- Outcome: Split decision. Neither the cash surrender value of the policies nor the premium receivable were included in the gross estate (the case did not directly address the valuation of the arrangement. But, a misstatement penalty was assessed for failure to value the property includible reasonably and in good faith (reporting approximately 25% of the value).
- Takeaway: A qualified appraiser (versed in defending conclusions to the Service) to conduct an analysis of receivables related to these arrangements is critical.

Case Update
Estate of Hoensheid v. Comm'r, T.C. Memo 2023-34 (March 15, 2023)

- <u>Relevant Facts</u>: Case involved assignment of income and availability of charitable deduction.
- <u>Issues</u>:
  - ❖ Did the taxpayer make a valid contribution of the shares of stock and, if so, when, and was the unreported capital gain income due to proceeds from the sale of those shares fixed before the gift?
  - ❖ Was a charitable contribution deduction available to the taxpayer and did accuracy-related penalties apply for the underpayment of tax?
- <u>Outcome</u>: IRS win.
  - ❖ The Tax Court held that an individual made a valid gift of stock in a closely held corporation to a DAF but, importantly, the right to income was fixed before the donation and, therefore, the taxpayer recognized gain on the sale of the stock.
  - ❖ The charitable deduction was denied due to failure to provide "qualified appraisal."
  - ❖ No penalty because reasonable reliance on attorney's advice, even though it was wrong.
- <u>Takeaway</u>: Get an appraisal!

Case Update
Estate of Cecil v. Comm'r, T.C. Memo 2023-24 (Feb. 28, 2023)

- Relevant Facts: Related to a tax valuation of voting and nonvoting stock of S corporation that owned Vanderbilt Biltmore House in Asheville, North Carolina (the largest privately owned house in the U.S., at 178,926 sq ft of floor space, still owned by Vanderbilt descendants).
- Issue: Taxpayer and IRS experts both tax affected earning of the S corporation in valuing the company under the income approach.
- Outcome: Taxpayer win.
- Takeaways:
  - ❖ After an extended discussion of the prior cases that rejected or allowed tax affecting, the judge begrudgingly agreed to tax affecting (experts on each side agreed to tax affected and the specific tax affecting method).
  - ❖ "We are not necessarily holding that tax affecting is always, or even more often than not a proper consideration for valuing an S corporation."
  - ❖ The court subsequently rejected the IRS's expert valuation, accepted the stock valuation of one of the taxpayer's experts before applying discounts and determining the appropriate discounts that should apply for lack of control and lack of marketability.

Case Update

Estate of DeMuth v. Comm'r, T.C. Memo 2022-72 (July 12, 2022)

- Relevant Facts:
  - ❖ Decedent's son, under a power of attorney that authorized him to make gifts, wrote 11 checks from decedent's account on September 6, 2015.
  - ❖ One of the checks was paid before decedent's death on September 11, 2015.
  - ❖ Three of the checks were deposited by the donees before decedent's death but not paid.
  - ❖ Remaining seven checks were all deposited and paid after decedent's death.
- Issue: Did the checks represent completed gifts?
- Outcome: Split decision; mostly IRS win.
- Takeaway: IRS conceded that the three deposited checks could be excluded from the estate but the Court held for the IRS on the remaining seven checks.

** Note, a charitable deduction is available even if check is not cashed until the following year (when donor is still alive!), but can avoid timing issues by making end-of-year gifts by cashier's check, wire, or electronic transfer.

** End-of-Year Gifts can be treated as gifted in the year the check was unconditionally delivered if it is cashed, deposited, or presented for payment within a reasonable time after the check was issued.

** End-of-Life Gifts (Rev. Rul. 96-56) conditions application of the relation back doctrine on the donor still being alive when the check is paid by the drawee bank.

IRS Audit and Enforcement

- Issues of Concern for the Service:
  - ❖ Valuation Discounts
  - ❖ Tax Affecting
  - ❖ Defined Value Clauses, i.e., *Wandry* Clauses
  - ❖ “Reciprocal” SLATs
  - ❖ I.R.C. Section 2036 challenges
- Practical Pointers:
  - ❖ Follow the formalities of the planning instruments.
  - ❖ Obtain qualified appraisals for each transaction.
  - ❖ Report and disclose the transaction accurately, correctly, and timely.
  - ❖ Know the process, what the examiner can and cannot do, and when you need backup.
  - ❖ Know when to run for cover!

Planning Principles

- “Use it or Lose it”: IRS has indicated that a taxpayer’s lifetime exemption amount (known as the “basic exclusion amount”) will be the higher of his allowable use in a particular year or the applicable basic exclusion amount in his year of death (*see* Anti-Clawback Regulations discussed supra).
- Potential retroactivity of proposed legislation.
- Formula gifting in light of valuation discounts and applicable remaining exemption amounts.

Popular Planning Techniques

- Use of Discounted Entities
- Grantor Retained Annuity Trusts (GRATs)
- Sales to Intentionally Defective Grantor Trusts (IDGTs)
- Spousal Lifetime Access Trust (SLATs)
- Gifts fully utilizing one spouse’s lifetime exemption
- Upstream transfers
- Grantor trust substitution of low basis assets
- Proceed with Caution:
  - ❖ Reciprocal Non-Reciprocal Trusts
  - ❖ Section 678, Beneficiary Defective Income Trust (BDITs)

Looking Ahead

- What Does Future Planning Look Like? Unfortunately, uncertain.
  - ❖ If recent legislative proposals are an indication of the future, planning will definitely not resemble the recent Golden Age of Estate Planning. Tools such as IDGTs, ILITs, SLATs, GRATs, BDITs could be eliminated or severely restricted.
  - ❖ Discount planning with closely-held businesses and family limited partnerships could be restricted or eliminated.
  - ❖ With lower exemptions and no ability to sell appreciated assets to grantor trusts, so called “shifted business opportunity” planning will become important again. This planning involves identifying investment or business opportunities before they have appreciated and sell or gift them to a non-grantor trust.
  - ❖ Discount planning with undivided interests does not appear to be implicated in the anti-discount proposals, so we will be watching how those opportunities develop.

Providing Value to Your Clients Through Periodic Review of Documents

- Fundamental (revocable) estate plan
  - ❖ Do dispositive provision comport with desires?
  - ❖ Are appropriate fiduciaries named?
  - ❖ Verify that the RAP language reflects amended language of Texas Property Code § 112.036.
- Dynasty Trusts
  - ❖ Are transfer documents, income tax returns, and gift tax returns correct and current?
  - ❖ Do transfer documents evidence gifts/sales thereto?
  - ❖ Do returns, transfer documents, and appraisals *all* match?
  - ❖ How are taxes, expenses, and insurance being paid on behalf the trust?
  - ❖ If a child/descendant (or trust for his benefit) owns an interest, ask: "how did he get that interest and was the transfer adequately disclosed."
  - ❖ Maintain balance sheets for trusts.

Providing Value to Your Clients Through Periodic Review of Documents

- Entities
  - ❖ Are Governing documents, transfer documents, and income tax returns correct and current?
  - ❖ Are there transfer documents evidencing contributions to the entity?
  - ❖ Maintain balance sheets for the entities.
  - ❖ How are taxes, expenses, and insurance being paid on behalf of the entity?
  - ❖ If a child/descendant (or trust for his benefit) owns an interest, ask: "how did he get that interest and was the transfer adequately disclosed."
  - ❖ Do returns, transfer documents, and appraisals *all* match?
  - ❖ Are the entities in good standing and are the clients respecting corporate formalities?
  - ❖ Does client have books and records for the entity and do the members/partners conduct an annual meeting and prepare minutes?
  - ❖ Is the client relying on distributions from the entity for personal use (or "living off the partnership") or is it making disproportionate distributions?
  - ❖ Is the client commingling personal assets with entity assets?
  - ❖ Have non-tax purposes for the entity been documented?

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Jana represents individuals and multi-generational families. She primarily focuses on tax planning, drafting complex wills and trusts, implementing wealth preservation strategies, and charitable giving. Jana emphasizes helping clients achieve their objectives by designing creative and functional solutions tailored to their specific goals—whether it involves business establishment or reorganization, or facilitating the administration of a trust or estate.

Jana draws from a vast breadth of experience in her law practice. Prior to joining the firm, she managed a large horse ranch and cultivated successful real estate and insurance practices. Jana's business-focused background allows her to understand her clients' concerns and employ a practical approach to tax, estate, and business planning issues.

She holds an LL.M. in Taxation from Georgetown University Law Center with an academic concentration in Estate Planning. During her time at Georgetown, Jana served as an extern for the United States Department of Justice, Tax Division. While working on her J.D., Jana completed her Master's degree in Personal Financial Planning, represented pro bono clients in tax controversy matters with the IRS, served as a Peer Financial Counselor, and clerked for the Honorable Robert L. Jones, United States Bankruptcy Court, Northern District of Texas.

Jana is admitted to practice law in Texas and is a Certified Financial Planner, CFP®.

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