Heckerling Themes and Takeaways:

Reviewing the Most Important Topics Discussed at the 2023 Institute

January 31, 2023

Jonathan Blattmachr, Esq.
Abigail O’Connor, Esq.
Martin M. Shenkman, Esq.

Agenda

- Heckerling Q&A Panel Takeaways
- Corporate Transparency Act
- SECURE 2.0
- Jurisdictional Discussions
- Synthesizing Comments from Multiple Speakers into a Defensive Estate Planning Practice
- Appraisals and the Gift Tax Statute of Limitations
- *Yost* and Family Disfunction
- Wandry Clauses and *Sorensen*

Takeaways from the Question and Answer Panel

Gift Tax Filing Requirements

Swaps

- Swapping assets into or out of a grantor trust. Should you report this? There is no filing requirement. You are trying to protect against a challenge that it was not of equivalent value. Panel recommends filing a gift tax return with this information.

- Reg. 301.6501(c)-1(f) provides you can do adequate disclosure of non-gift transaction. This is only authority. Hope is this would run statute of limitations on inadvertent gift.

- Consider using a Wandry formula gift (where you express the gift not as a percentage of what is owned but by a dollar value of what you own (and gift). Not mentioned but that is key if you are concerned about a gift issue.

Gift Tax Filing Requirements

GST:

Consider filing a Form 706 for GST purposes, even if not otherwise required because of the estate tax exemption. Allocate GST exemption on Schedule R if you do not want to rely on automatic allocation. (You can always file a Form 706 even if you do not have assets that exceed the filing requirement.) The same is true for filing a form 709 – file to ensure the desired GST treatment.

Charity:

Reporting donor’s charitable contributions deducted for income taxes on Form 709. Must report these. Code requires that fully charitable gifts be reported on Form 709 unless all gifts are under annual exclusion threshold. This is one of the most overlooked Form 709 issues. Penalty for omission of gifts in excess of 25% of reported gifts, e.g., if have large charitable gifts that are not reported could extend statute of limitations from 3 to 6 years.

Valuation

- How do you go about getting an appraisal as of the date of the gift, since appraisals are not produced overnight and can take months? How do you get certainty?
- Risk it and get appraisal later if certain about value of the gift.
- Go ahead and get an appraisal earlier and have the appraiser update the appraisal up to the date of the gift.
- As long as nothing drastic happens the earlier appraisal should be sufficient although you should have the appraiser reconfirm as of the date of the transfer.
- If that does not work, use a Nelson type clause, making gift based on appraised value when it comes in or, you can use a Wandry clause to adjust the gift tax value as finally determined. Why not do both?
- Adequate disclosure regulations give safe harbors (including appraisal safe harbor) which requires that the appraisal state the date as of which the transfer is made. A prior date may not satisfy the adequate disclosure rules.

SLATs and Community Property

- Spouses must first partition or transmute, via agreement, so each spouse contributes separate property into a trust for the benefit of the other spouse.

- There is a huge shift in marital assets as a result of the SLAT plan in a community property jurisdiction.
    - Example: $50M community property ($25M per spouse)
    - Partition $20M so that H&W now each have $10M of separate property and $15M community (Still $25M per spouse)
    - If H gifts $10M to a SLAT for W (and W does not create a reciprocal trust), W has $10M SP, $10M in trust, and her $15M share of the community property, while H has only his $15M share of the community property. Community assets are now $30M instead of $50M, which is a massive shift of value of assets and clients should be counseled as to the impact of this. Perhaps, each should have separate counsel.

The Corporate Transparency Act (“CTA”)

Corporate Transparency Act - Overview

- This is the biggest issue coming in the next 12 months and it is not getting nearly enough press. The CTA applies to most small businesses as discussed below, and many of us and our clients.

- All of us will be getting personal **FinCEN** (Financial Crimes Enforcement Network) numbers.

- The new rules go into effect January 1, 2024, so we have 11 months to get ready.

- FinCEN will create a central database and collect information on the individuals behind "reporting companies" that will help law enforcement catch money-launderers, terrorist, and other financial criminals.

- This approach is common in Europe, the U.S. is behind the times.

Corporate Transparency Act - Compliance

Foundational concept of the CTA: Reporting companies have to file Beneficial Ownership Reports with FinCEN. Three key questions:

- What is a “reporting company?”
- What is included in a “beneficial ownership report?”
- When does the reporting company have to file the report?

Corporate Transparency Act – Reporting Companies

What is a Reporting Company?

- Domestic reporting company: Corporation, limited liability company, or other entity created by the filing of a document with a secretary of state or any similar office under the law of a State or Indian Tribe.
- Foreign reporting company: Corporation, limited liability company, or other entity formed under the law of a foreign country; and registered to do business in any State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a State or Indian Tribe.

Important to estate planners:

A trust is not a reporting company. Why? It is not created by filing a document with the State. Even if a trust is required to be registered, unless the registration is required for the trust to be created, the registration requirement does not make the trust a reporting company. Many trusts will be beneficial owners, however, and will be involved in the reporting requirements as beneficial owners.

Corporate Transparency Act – Reporting Company Exemptions

Exemptions: These entities are not reporting companies.

Exemptions that include subsidiaries: "Large Operating Companies;" churches, charities, nonprofits and other 501(c) entities; political organizations; charitable trusts; registered public accounting firms; certain governmental legal entities; issuers of securities who are registered under the Securities Exchange Act; FDIC-insured banks, credit unions, and deposit institution holding companies; securities brokers and dealers; registered investment companies and advisors; venture capital firms required to file with the SEC; insurance companies and certain U.S. insurance producers; Commodity Exchange Act registered entities; retail foreign exchange dealers registered with the Commodities Futures Trading Commission; regulated public utilities; financial market utilities designated by the Financial Stability Oversight Council.

Exemptions that do not include subsidiaries: Entities that serve only to provide financial assistance or oversight of exempted nonprofits; Money transmitting businesses and money service businesses that are registered with FinCEN; Certain pooled investment vehicles operated by certain CTA-exempted entities; "Inactive" legal entities ("grandfathered").

Corporate Transparency Act – Reporting Company Exemptions

So Which entities are ***not*** exempt?

- Most of our clients' entities!
- Mom and pop businesses with less than 20 employees or less than $5 Million gross revenue
- Many law offices, solo practitioners who are not sole proprietors.
- LLCs created to hold clients' real estate.
- Family limited partnerships and LLCs formed for investments.

Practice tip: What if one is unsure whether the entity is exempt? As of now there is no way to ask, so the most conservative approach is to err on the side of caution and file the report. (Maybe in the future there will be a way procedure similar to a private letter ruling.)

Another practice tip: If a client has a company that would qualify as a "large operating company" except it does not because the employees are employed by a wholly owned subsidiary, consider whether a restructuring is worthwhile so that the parent company has the employees and qualifies as a large operating company, which should exempt the parent and the wholly-owned subsidiary.

Corporate Transparency Act – the Beneficial Ownership Report

The Beneficial Ownership Report – What is it?

- FinCEN has not yet produced as sample form.

- The report will require information on:
  1. The reporting company
  2. Beneficial owners
  3. Company applicants (for entities created or registered after January 1, 2024).

- Beneficial owner definition: Any individual who, directly or indirectly, either:
  1. Exercises substantial control over the reporting company; or
  2. Owns or controls at least 25% of the ownership interests of the reporting company.

Corporate Transparency Act – Beneficial Owners

Who are "Beneficial Owners?"

- Any individual who, directly or indirectly, either (1) exercises substantial control over the reporting company or (2) owns or controls at least 25% of the ownership interests of the reporting company.

What about Trusts?

- Fiduciaries and other non-beneficiaries
- Trust beneficiaries

Corporate Transparency Act – Trusts

Fiduciaries and other non-beneficiaries:

- Individual trustees
- Others with power to dispose of trust assets (investment advisors? directors of directed trusts?)
- Someone who holds a power of appointment, even in a non-fiduciary capacity?
- Someone who holds a veto power over trust distributions?

Trust Beneficiaries:

  - Sole permissible recipient of income and principal from the trust
  - Beneficiary who has the power to demand or withdraw substantially all of the trust assets
  - Grantor of a revocable trust
  - Grantor of an irrevocable trust if the grantor has the power to withdraw substantially all of the trust assets – does that mean a substitution power makes the grantor a beneficial owner for reporting purposes?
  - Maybe good news: it appears the multiple beneficiaries of sprinkle-type trusts may be excluded from being reported as beneficial owners

Corporate Transparency Act – Company Applicants

Who are "Company Applicants?" (For companies created after January 1, 2024.)

- Two categories:
  1. Individual who actually files the paperwork with the agency to create the company.
  2. Individual who oversees the individual who files the paperwork.
- Example: The paralegal who goes online to file articles of incorporation, and the attorney who oversees the paralegal. Both are company applicants.

Practice tip: Rethink who files with the state. Perhaps have 1-2 people in charge of this process or walk clients through filing online by themselves. However, is the lawyer still overseeing?

Practice tip: FinCEN numbers can be used in lieu of personal information about company applicants on the reports.

Corporate Transparency Act – Filing Deadlines

Deadlines for filing reports (no extensions as of now):

- Initial reports:
  - For companies formed prior to 1/1/24, the initial report is due “no later than” 1/1/25
  - For companies formed after 1/1/24, the initial report is due 30 days from creation
  - If an exempt company becomes nonexempt, the initial report is due 30 days from when the company becomes nonexempt.
- Ongoing reporting requirements:
  - There is no annual filing requirement; new reports are driven by events. Any change in the information submitted in a report requires a new report within 30 days, including changes in beneficial ownership (and change of driver’s license number, passport number, etc.)
  - Corrected reports are due 30 days from when an inaccuracy is discovered.

<u>Practice tips:</u> Update planning checklists. Consider client letters when entities are formed setting out the requirements so clients are on notice. Consider having clients sign an acknowledgement as to responsibility for filing the reports . Update probate checklists so that fiduciaries are aware of the requirements when distributing a decedent’s interest in an entity.

Corporate Transparency Act – The Future

- We need to keep our eyes open to further developments that will impact our clients and our practices.

- There have been suggestions on various levels to try to apply these same concepts to trusts themselves.

- There also have been suggestions that lawyers become mandatory reporters of suspicious activity. Example: ENABLERS Act of 2021

SECURE 2.0

What is SECURE 2.0?

- 350+ page bill (included in Consolidated Appropriations Act of 2023
- Revenue Neutral Bill passed with bipartisan support (415-5)
- Includes enhancements to retirement savings, some of which impact estate planning

SECURE 2.0 Highlights

- Increased age of required beginning date (RBD) for required minimum distributions (RMDs)
  - RBD increased to age 73 for persons reaching 73 after 2022
  - By 2032 RBD will increase to age 75

- If age 60-63 there is a leniency for makeup contributions

- Roth election can be made on makeup contributions (this is 1/3 of the revenue raised in the bill)

- Unused funds in 529 plans can be rolled into Roth IRA if 529 plan was open for at least 15 years

- Excise tax for failure to take RMD reduced from 50% to 25% (can be reduced to 10% if a timely correction is made)

SECURE 2.0 Highlights, cont'd.

- Enhancement to Qualified Charitable Distribution (QCD): Once per lifetime, may transfer $250,000 into a charitable remainder trust or charitable gift annuity
  - CRT must require distribution of at least 5%/year
  - For younger people, the math may not work in order to qualify

- For 401k plans with a Roth election, lifetime distributions starting at RBD no longer required

InterActive Legal

SECURE 2.0 – Distribution to Certain Charities from an AMBT

- SECURE created two special types of accumulation trusts for chronically ill or disabled beneficiaries: Applicable Multi-Beneficiary Trusts (AMBTs)
  - Type 1 AMBT: Trust immediately separates on death, so chronically ill/disabled beneficiary has separate trust
  - Type 2 AMBT: Trust includes multiple beneficiaries but retirement benefits can only be used for chronically ill/disabled beneficiary during that beneficiary's life

- Many families wish to name a charity as beneficiary of an SNT once the primary beneficiary dies; under the rules before SECURE 2.0, they could not do this without jeopardizing the lifetime stretch for the disabled or chronically ill beneficiary

- SECURE 2.0 now allows distributions from a Type 2 AMBT to a "qualified charitable organization" under Section 408(d)(8)(B)(i) of the Code (note: no DAFs or private foundations)

- **Note** – language regarding this change was added to InterActive Legal documents in January.

Jurisdictional Discussions

Jurisdiction/Governing Law for Trusts

- If you are creating a DAPT, which states may be preferable?
- If you are seeking to decant a trust, which states may be preferable?
- Where should the situs be for a dynasty trust?
- Things to consider:
  - State income taxes
  - Level of creditor protection
  - Should trustee have permission (or a duty) to move a trust if the law elsewhere is better?
  - The more contacts with situs jurisdiction the better.
  - If settlor is not resident of state you are choosing as situs for the trust, then the trustee must be in that other jurisdiction - physical presence, custody of assets, administration.
  - Some states have eliminated the rule against perpetuities entirely. A GST exempt trust can remove assts from reach of estate tax forever if no RAP.
  - Can a nonresident settlor create a trust in a state with a longer RAP than his home state? Consider a RAP savings clause.

Jurisdiction/Governing Law for Trusts

More issues to consider:

- Directed and Delegated Trusts.
- Trust protectors
- Prudent investor rule.
- Spendthrift protection
- Non judicial changes, such as decanting or non-judicial settlement agreements between parties.
- Quiet/Silent Trusts.
  - May prohibit trustees from providing information to beneficiaries
  - Note that limitations period on suit may not run if no disclosures
  - Duty to inform in some states is a default law, so can waive it.
  - If settlor wants the terms of a long-term trust private, the trust should be established in a state that permits a silent trust or a state which permits a designated representative.

Synthesizing Comments from Various Heckerling Presentations Into a Defensive Estate Planning Practice

Defensive Estate Planning - Overview

- This section of comments is intended to build on and expand discussions from various Institute programs in a way to help practitioners adapt the advice from the Institute to their practices.
- Different speakers made statements appropriate to their topics that may have different considerations in other contexts. Practitioners must synthesize often competing, even contradictory, goals and considerations, when practicing, which is tough to do.
- For example, how does a practitioner balance documenting tax risks or a client's noncompliance with recommendations, versus concern over creating a roadmap for an IRS auditor? This analysis will also vary by practitioner since we each practice differently, have different client profiles, and different risk tolerances. (As but one generalization some of us may grow more risk-averse as we near retirement age.)
- The discussions below include comments from many different presentations reframed to suggest how the planning points presented might be applied in a broader practice context in a manner that may enhance defensive practices.
- As an overall comment, the current malpractice environment should always be considered.

Defensive Estate Planning – Grantors Trusts and Basis

- Taking the position that assets in a grantor trust that are not included in the client's estate but nonetheless qualify for a basis step up was discussed by some speakers.

- From a defensive practice position, practitioners who have taken this position, or were contemplating taking that position, should carefully evaluate the comments made. (More discussion of the specifics are in the handout.)

- Practitioners likely should consider and advise clients of the differing views in the legal community and specify why they are willing or unwilling to take a particular position.

Defensive Estate Planning – SLATs

- Varying positions regarding whether to use SLATs
  - Always use them? Or only for some clients?
  - “SLAT” as a marketing term/tool

- Reciprocal Trust Doctrine concerns
  - DAPT jurisdiction protection
  - How much time spent to address the issue (i.e., differentiating between trusts)
  - Don’t use just one means of differentiating (e.g., *Levy*)
  - Timing
  - *Estate of Grace*

Defensive Estate Planning – Terminating Clients

- What approach should be taken with respect to clients who are reticent to proceed with planning the practitioner believes to be important to do?
- Consider documenting the advice given to the client in writing. Evaluate if the communication should also document what alternative action the client opted to take and the potential negative consequences.
- If the client's non-compliance is sufficiently concerning to the practitioner, the practitioner may evaluate withdrawing from the client relationship.
- Consider the issue of terminating clients through the lens of recent, significant, and worrisome, malpractice cases that have occurred.
- The optimal time to "terminate" a bad client is before engagement.
- If you have plenty of business, getting rid of bad clients should be considered.

Defensive Estate Planning – Audit Risk

- For many strategies, there may be an alternative with a lower audit risk
- Specific discussion of Wandry-Type clauses – higher risk of audit, so consider other options
- Perhaps practitioners should disclose several options to the client, pointing out, ideally in a written communication the uncertainty or risk with each and let the client determine which approach to use.

Defensive Estate Planning – Income Swapping

- One presentation discussed an interesting concept that might alleviate some client concerns. The client can swap assets they still hold, presumably illiquid ones, into an irrevocable grantor trust for the income earned in and held by the trust.
- Be mindful of Sec. 2036 issues.
- Consider carefully warning clients of the issues and risks.
- Other options to address this might be incorporating loan, SPAT, DAPT, or hybrid DAPT provisions providing other avenues to access cash.
- Perhaps caution is in order from another perspective. If the practitioner has to tie the planning into a pretzel to help the client become comfortable with the plan, perhaps the client should not be doing the planning until they become comfortable.
- Consider whether to report such a swap on a gift tax return
- Not discussed but worth considering is using a Wandry-type clause to assure equivalent values of what is swapped in or out. Since the planning suggestion necessarily includes swapping in non-liquid assets those may well be hard to value assets and the incorporation of a Wandry clause into the formula may be advisable.

Defensive Estate Planning – Client Files

What should you document in the file?

- Caution was suggested in documenting warnings to clients to avoid those being included in the client file.
- From a defensive practice lens practitioners should consider the lessons of several recent malpractice cases wherein clients have argued that they were not informed of certain risks to the plan.
- Carol Harrington made the following comments: “Clients may not remember verbal warnings of risks we tell them…Risky to give in writing but not giving in writing is risky to the practitioner. So put it in writing.” Amen.
- SLATs have many issues in this regard – potential divorce, reciprocal trusts, and more.
- Consider how billing entries are crafted

Appraisals and the Gift Tax Statute of Limitations

Adequate Disclosure Regulations

- To trigger the 3-year statute of limitations, gifts must be adequately disclosed on a gift tax return (Form 709) or statement attached to the return for the year in which the transfer is made

- The requirements for “adequate disclosure” are set forth in the Regulations (Treas. Reg. Sec. 301.6501(c)-1(f))

- The requirements for adequate disclosure are nitpicky (Google “adequate disclosure checklist”)
  - E.g., if transfer is to a trust, must include a summary and “verified” or “certified” copy of the trust
  - E.g., if publicly traded stock, must include exchange on which traded and CUSIP number

Appraisal Requirements

- To satisfy the adequate disclosure requirements, an appraisal must include the date of transfer, date of appraisal, and purpose of appraisal (Treas. Reg. Sec. 301.6501(c)-1(f)(2)(iv) and (f)(3)(ii))

- Most appraisers do not include the date of the appraisal in the report

- What to do? Recommend to clients, in writing, that an appraisal be obtained that includes the date of the appraisal

- What about the date of transfer? Is it sufficient to include date of transfer on the return?

<u>The *Yost* Decision and Family Dysfunction</u>

Yost v. Carroll, N.D. Ill., No. 20 C 5393 (Jan. 20, 2022)

- Mr. Yost (Plaintiff) filed suit against his soon-to-be-former son-in-law (Defendant) for repayment of loans in excess of $7 million
- Defendant counterclaimed and presented affirmative defenses, claiming that the loans were in fact gifts
- Defendant offered into evidence a letter from Plaintiff to Plaintiff’s daughter (Defendant’s soon-to-be ex-wife) telling her to sign the promissory notes to avoid gift tax

Yost v. Carroll - Takeaways

- Defendant’s counterclaims and defenses were dismissed without prejudice
- However, this case still teaches an important lesson: It points out the dangers to practitioners of getting involved in family dynamics, particularly where divorce (or perhaps sibling rivalry) are involved
- Clients too often sign “gift letters” stating a loan was a gift in order to pacify child’s lender

<u>Wandry Clauses and the *Sorensen* Case</u>

Sorensen v. Commissioner

- Sorensen v. Commissioner, Tax Ct. Dkt. Nos. 24797-18, 24798-18, 20284-19, 20285-19 (decision entered Aug. 22, 2022)
- The case involves unusual context but still offers valuable lessons in structuring and administering *Wandry* style defined value transfers
- Facts:
  - In 2014, each brother made a gift of nonvoting stock in the family business to a grantor trust
  - Transfer documents provided for transfer of "…A specific number of nonvoting shares in FIREHOUSE RESTAURANT GROUP, INC., a Florida corporation (the 'Company'), that have a fair market value as finally determined for federal gift tax purposes equal to exactly $5,000,000…"
  - Family then sold additional shares to the trusts in 2015, not using *Wandry* clauses

Sorensen v. Commissioner – Continued

- Additional Facts:
  - On gift tax returns, they reported the defined value formula transfers as follows: "the donor transferred 9,385 non-voting shares in Firehouses stock . . . with a value equal to $5,000,000, and the precise number of shares transferred cannot be finally determined until the value of such shares are finally determined for federal gift tax purposes."
  - 2015 sales were not reported as non-gift disclosures
  - The company reported that each trust owned 9,385 shares on stock ledgers and on income tax returns
  - Trusts received pro rata distributions based on ownership of 9,385 shares
  - Trusts sold 9,385 shares to a third-party purchaser, with no acknowledgment that the exact number of shared owned by trusts had not been determined
- IRS argued that the *Wandry* defined-value clause was not effective
  - Donors relinquished dominion and control of all the shares in 2014 so the full amount of shares were transferred
  - Company reporting did not comport with the defined-value transfer
  - The recipient trusts did not agree to the defined-value transfers
  - Third-party purchasers were not made aware that exact number of shares owned had not been determined

InterActive Legal

Suggestions for Consideration

- The Heckerling panel offered some suggestions to account for lessons learned from Sorensen; these comments expand on those suggestions:
  - Legal documentation effectuating sale or transfer should make clear that the transferor has only relinquished control over the fixed dollar amount of shares
  - Add an asterisk to company reporting documents and returns explaining that the number of shares are estimated for administrative convenience (or attach a statement to the K-1 or other return if asterisk is not possible)
  - Transferor's personal financial statement should reflect intended transfer in a footnote (do not include trust's interest)
  - Counsel should review trustee records and disclosures to ensure they are consistent and accurately reflect the defined-value transfer
  - Trusts should sign agreement or stock powers with terms of transfer; also, consider holding shares in escrow pending resolution of contingency of gift tax value as finally determined
  - Documentation for any subsequent purchase of shares by third-party buyer should include acknowledgment that number of shares owned by trusts is uncertain

Closing Remarks

Upcoming Events*

- Only at InterActive Legal: The ExtraCrummey Trust℠: February 15
- InterActive Legal Academy – Estate Planning Basics Series: May 9-June 2
- InterActive Legal Academy – Estate Planning Tax Series: October 2-27

*Dates and times subject to change