Updates in Estate Planning

Andrew M. Katzenstein, Esq.
Proskauer Rose LLP
akatzenstein@proskauer.com
310-283-3600

Caroline Q. Robbins, Esq.
Proskauer Rose LLP
crobbins@proskauer.com
310-284-5456

Orange County Estate Planning Council
The Pacific Club
4110 MacArthur Blvd.
Newport Beach, CA 92660
January 23, 2024 5:30 pm – 8:30 pm

Proskauer

2024 INFLATION ADJUSTMENTS

- The applicable exclusion amount is increased from $12,920,000 to $13,610,000 for 2024.
- The GST exemption is similarly increased from $12,920,000 to $13,610,000 for 2024.
- The annual gift tax exclusion increased from $17,000 to $18,000 for 2024.
- The annual exclusion for gifts to non-citizen spouses increased from $175,000 to $185,000 for 2024.

INCREASED INTEREST RATES IMPACT ESTATE PLANNING

- The applicable federal rate ("AFR"), on account of inflation, has increased substantially.
- Compare:

	1/2022	1/2023	12/2023
Short Term	0.44%	3.84%	5.26%
Mid Term	1.30%	3.85%	4.82%
Long Term	1.82%	4.5%	5.03%

- In the past 24 months, rates have gone from historically low to high rates. There has also been a "rate inversion" – where the short-term rate is not less than the mid-term rate or the long-term rate.
- This alters the effectiveness of estate planning techniques that are based on interest rate assumptions.

WHAT WORKS WHEN INTEREST RATES INTEREST RATES ARE HIGHER?

- Qualified Personal Residence Trusts ("QPRTs") allow a parent to gift their personal residence to a trust, keep the right to live there for a specified term, and at the end of that term for the residence to pass to (typically) a grantor trust for children. The value of the gift to the QPRT is reduced by the actuarily determined value of the parent's right to reside there for a specified number of years. The calculation is done using the "7520 Rate".
- Assume that a 65 year old parent owns a $10M home and establishes a QPRT for 10 years.
- Compare the actuarily determined value of the parent's gift if made on 1/2022, 1/2023, or 12/2023:

WHAT WORKS WHEN INTEREST RATES ARE HIGHER?

	1/2022	1/2023	12/2023
Gift	$7,007,900	$5,238,500	$4,677,800

- With an increasing 7520 Rate (1.6% for 1/2022, 4.6% for 1/2023, and 5.8% for 12/2023), the value of the parent's retained interest increases, meaning the value of the parent's gift decreases.
- Combined with a drop in values for residences also resulting from increased mortgage rates that have, in many places, depressed prices, QPRTs are much more advantageous now than they have been in the recent past.
- Creating more than one QPRT and therefore being able to gift non-controlling interests in the residence that can be discounted enhances the QPRT advantage in the current environment.

WHAT WORKS WHEN INTEREST RATES ARE HIGHER?

- Don’t forget QPRT downsides:
  - Grantor must outlive the term for the technique to result in transfer tax savings. Death before the end of the term causes the assets to be included as part of grantor’s taxable estate.
  - GST exemption can’t be allocated to the asset until the end of the QPRT term. So not a good vehicle to use if passing assets to more distant generations is the goal.
- Remember to have remainder beneficiary of the QPRT be a grantor trust, so that if parent wants to continue to live in the residence he or she can rent the house back without there being income tax on the rent payments (effectively the rent passes gift and income tax free to grantor trusts for children.

WHAT WORKS WHEN INTEREST RATES ARE HIGHER?

- In a higher interest rate environment, a CRAT is more attractive than a CLAT.
- Note that any trust which makes “unitrust” payments really aren’t affected by a change in interest rates.
- One way to mitigate the impact of higher interest rates in the context of sales to Intentionally Defective Irrevocable Trusts (“IDITs”) is to use discounting in making the sale.

MOORE V. UNITED STATES

- The U.S. Supreme Court heard arguments in the *Moore v. United States* case on December 5, 2023.
  - The case involves whether or not a taxpayer who owned shares in a foreign corporation that was majority American owned has to pay income tax on the corporation's profits that hadn't yet been distributed.
  - Although the 16th Amendment allows for tax to be imposed on "income", taxpayers argued that the profits of the foreign corporation were not "income" because taxpayers hadn't received those profits. The income had not yet been realized, so it should not be subject to income tax.
  - Pundits believe that the Court is likely to permit taxation of these undistributed profits.
- How might such a ruling impact estate planners?

MOORE V. UNITED STATES

- Not too long ago, Bernie Sanders put forth a wealth tax as part of his tax proposals.
- A wealth tax is ostensibly a tax on appreciation in value not yet realized.
- Many believe that is the same as the situation in *Moore* – the owner of stock in *Moore* could be taxed on profits not yet distributed to the taxpayer – not realized. If that is permitted, then shouldn't the U.S. be able to impose a tax on appreciation in value not yet recognized?

• Estate planning attorneys should keep a close eye on this decision.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- The Corporate Transparency Act ("CTA") requires a range of entities, primarily smaller, otherwise unregulated companies, to file a report with the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") identifying the beneficial owners (i.e., the persons who ultimately own or control the company) and provide similar identifying information about the persons who formed the entity ("company applicants").
- For entities formed prior to January 1, 2024, the information must be provided before January 1, 2025. It is the company that has the obligation to report.
- NOTE: can only report electronically. BOI E-FILING (fincen.gov) is now up and reports can be filed.

IMPACT OF CORPORTE TRANSPARENCY ACT ON ESTATE PLANNING

- A reporting company must report (a) the entity name and any d/b/a names; (b) business street address; (c) jurisdiction of formation; and (d) a unique identification number (like a TIN, EIN, etc.).
- For company's formed after 1/1/24, the company must report its "company applicant." There can be up to two company applicants.
- Company must also identify "beneficial owners" by providing (a) full legal name; (b) date of birth; (c) current residential or business street address; and (d) a unique identifying number from an acceptable identification document (such as a driver's license or passport) along with an image of that document.
- You can obtain a FinCEN identifier online for any of the above.

IMPACT OF CORPORTE TRANSPARENCY ACT ON ESTATE PLANNING

- FinCen identifiers can be helpful when you have an individual (or company) who must be listed on multiple reports because the FinCen identifier can be used in place of filling out all the required information for the individual (or company) on each report.
- Individuals: Obtain by providing full legal name, DOB, address, unique identifying number and issuing jurisdiction from acceptable ID and an image of the ID.
- Reporting Companies: Obtain by checking a box on the beneficial ownership information report upon submission.
- Update information required for FinCen identifier within 30 days of any change.

IMPACT OF CORPORTE TRANSPARENCY ACT ON ESTATE PLANNING

- A “beneficial owner” is a person, directly or indirectly, that either(a) exercises substantial control over the reporting company or owns or (b) controls at least 25% of the ownership interests of the reporting company.
- A beneficial owner does *not* include minor children (so long as parent or legal guardian’s information is provided). A beneficial owner also does not include individuals acting as nominees, custodians or agents, an individual whose only interest in a reporting company is a future interest through a right of inheritance, or creditors of the reporting company (unless such person otherwise meets the definition of beneficial owner).

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- A person can be deemed a beneficial owner if he or she exercises “substantial control” which is defined as a senior officer (CEO, CFO, general counsel, or any other officer performing a similar function), someone with authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body) of the reporting company, or someone who directs, determines or has substantial influence over important matters of the reporting company (e.g., dissolution or merger, selection or termination of business lines, amendment of governance documents), or someone who has any other form of substantial control over the reporting company.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- Note that a person who exercises substantial control is a beneficial owner for reporting purposes even if he or she doesn't own 25% of the reporting entity. The "control test" is separate and apart from the "ownership test" for purposes of deciding who is a "beneficial owner" that the reporting company must disclose Treasury Regulations Section 25.2518-3(b) permits a qualified disclaimer to be made by designating a "percentage" of the property being disclaimed.
- An "ownership interest" is broadly defined – includes equity, stock, capital, or profits interest. A person can own or control an ownership interest of a reporting company directly or indirectly – including through joint ownership, *certain trust arrangements*, or acting as an intermediary, custodian or agent on behalf of another.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- A revocable or irrevocable trust will generally not be treated as a "reporting entity". Therefore, the trustee of the trust and the trust beneficiaries have no reporting duties.
- However, family limited partnerships and LLCs, as well as close corporations commonly used in estate planning transactions, will be "reporting entities".
- If there is a duty to report, it is the *reporting company's* duty.
- "Beneficial owners" of reporting companies would include the trustees and (current, not future) beneficiaries of trusts that hold 25% of any reporting company.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- Trustees of trusts can also be deemed "beneficial owners" of reporting companies because of the "control test". For example, if a trustee is a member of a member managed LLC, the trustee would likely exert "substantial control" and be deemed a "beneficial owner" for reporting purposes.
- Investment advisors of directed trusts could also be treated as "beneficial owners" because they exert substantial influence over important matters of the reporting company.
- If a reporting company has a distributions or liquidation advisor to avoid application of the *Powell* decision, such person(s) would exert substantial influence over important matters of the reporting company and, therefore, need to be reported as "beneficial owners".

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- It is unclear whether a person who has the right to remove and replace a trustee of a trust that owns a reporting company must be identified in that reporting company's BOIR. The statute speaks to the ability to remove and replace "officers" but not trustees, so at first look persons with the power to remove and replace trustees would seem not to be "beneficial owners"
- Keep in mind that changes in who is a beneficial owner must also be reported by the reporting entity.
  - If there is a change in trustee of a trust owning the reporting company.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- If a parent creates an LLC (which is a reporting company and files its BOIR report on creation) and then gives or sells that LLC interest to a grantor trust for children, another BOIR report will need to be filed by the reporting company, and if it was a sale for a note and the interest in the reporting company is returned to the seller to repay the note another BOIR report will need to be filed.
- When a reporting company is formed a BOIR report will need to be filed, and if that reporting company is then given to a GRAT another BOIR report will need to be filed – and if the annuity payments are made by return of an interest in the reporting company, another BOIR report will be required.

IMPACT OF THE CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- In each circumstance, analysis must be undertaken as to whether the “control test” and/or the “ownership test” (it could be one, both, or neither) require reporting. For example, if the parent is the trustee of the GRAT and less than a 25% interest in the reporting company is returned to the parent in payment of the annuity, the “beneficial owner” test wouldn’t require reporting because parent wouldn’t have received 25% of the reporting company back. It is unclear whether the “control test” would require reporting because parent as an individual and parent as the trustee are the same human being – even though their control prior was exercised only as trustee and after the annuity payment control would be exercised as a person.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- Rules state that "death is not a change" that triggers the 30-day reporting requirement. However, when the estate "settles" the 30 days will start to run. If the reporting company passes through a probate estate, then when the court orders that asset distributed the 30 days would seem to begin.
- When the reporting company passes as part of a living trust, the 30 days would likely begin to run when the trustee distributes the reporting company from the revocable trust to, for example, the bypass trust or the marital trust or the survivor's trust.
- Penalties for willfully providing false information or willfully failing to report include (a) $500/day up to $10,000 and/or (b) 2 years in jail.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- Practically, the reporting company must be made responsible for reporting. Estate planners cannot take on this responsibility. It would leave no one time to do other work, and there is too much liability for taking on that responsibility when what happens to a reporting corporation is not known to the estate planning attorney on a real time basis.
- Mailings notifying clients that own reporting companies must be sent, if not sent already.
- When estate planning transactions are undertaken, reference to the requirements of the CTA and the fact that the estate planning attorney will not be responsible for the filings (but will be available to answer questions) should be included.

IMPACT OF CORPORATE TRANSPARENCY ACT ON ESTATE PLANNING

- Many accounting firms, like most of the law firms, are announcing that they will not be primarily responsible for these filings. (The accounting firms deem this legal work that they will not do.)
- If lawyers and accountants won't do this for clients, who will?
- Already there are independent companies sending emails that they will take on this task. https://fincenguidance.com is one group that has reached out; for $129/year this entity claims that it will do all of a company's filings for one year. CT Corp. is also coming into the field, and is likely to take on a lot of this work. Another company called Eminutes is getting into the business.
- Keep your eyes out for a reputable company to refer clients to.

SECURE ACT 2.0

- This act became effective January 1, 2023.
- A mention here because it is an important 2023 “change to the law”.
- There have been many seminars that go into this topic in depth.
- For purposes of today, estate planners should be aware of:
  - Increased age for required minimum distributions from 72 to 73 as of January 1, 2023, and then again to 75 on January 1, 2033.
  - An individual aged 70-1/2 or older can make a qualified charitable distribution up to $100,000 from an IRA to a qualified charity without recognizing income on the donated amount. For years after 2023, that $100,000 will be indexed for inflation.

SECURE ACT 2.0

– For individuals aged 70-1/2 or older, a one-time qualified charitable distribution of up to $50,000 from an IRA to a charitable gift annuity, CRUT or CRAT that benefits the participant or their spouse. The $50,000 one-time qualified charitable distribution can count toward the individual's required minimum distribution. Note: after a CRAT is established there can be no further contributions, and a qualified charitable distribution-funded CRUT must be funded exclusively with IRA qualified charitable distribution assets, so both of these are unlikely to be used in this context.

USE IT BEFORE YOU LOSE IT PLANNING

- The applicable exclusion amount is scheduled to be cut in half on January 1, 2026, from what it is on December 31, 2025.
- It will take Congressional action to stop that from happening. NOTE: this is different than in the past when there were rumors of this occurrence. Here, it takes and act to stop the reduction, rather than in the past when it would have taken an act to cause a reduction.
- Congress doesn’t seem to be able to come together on much of any legislation. Therefore, it is likely the risk of the applicable exclusion amount actually falling in 2026 is greater than that risk in prior years.
- NOTE: if planning is done to avoid the reduction and it doesn’t occur, clients are still better off making gifts sooner rather than later.

USE IT BEFORE YOU LOSE IT PLANNING

- A person must give away more than half of what he or she thinks the applicable exclusion amount will be in 2025 to use anything before it's lost. For example, if the applicable exclusion amount is $14M in 2025, and it will drop to $7M, unless a gift of more than $7M is made before the end of 2025 nothing is gained.
- For that reason, perhaps one spouse should gift $14M and the other nothing. That way, $7M is used before it's lost. And the other spouse has his or her $7M exemption left. Compare to both spouses gifting $7M before 2025; in that case, $14M is transferred but neither spouse has any exemption left.
- Consider gifting assets that clients don't need to live – art, jewelry, residences that don't generate income, growth stocks that don't pay much in dividends.

USE IT BEFORE YOU LOSE IT PLANNING

- SLATs help couples who can't really afford to give away their applicable exclusion amounts. Remember that they cannot be reciprocal. Consider, for example, having H create a SLAT for W, and W create a "hidden SLAT" (a trust for children with the ability to appoint a trust protector to add H in as a beneficiary in the future if H and W run out of money and spend down the SLAT created by H for W).
- Address consequences of divorce in the context of SLAT planning.
- Consider having couples loan funds to an IDIT for children, and forgiving loan on December 31, 2025 if applicable exclusion amount looks like it will be cut in half and having trustee of IDIT repay the loan if the applicable exclusion amount will remain unchanged.

USE IT BEFORE YOU USE IT PLANNING

- Appraisers and lawyers will be very busy from the middle of 2025 until year end helping clients make these gifts.
- The smart clients are starting now, so that they don’t get stuck at the end of 2025 and find themselves unable to complete their gifts because professionals lack the bandwidth.
- Consider sending letters to clients in early 2024 alerting them to this upcoming change in the law.

CALIFORNIA'S DIRECTED TRUST STATUTE

- California enacted a directed trust statute. Its effective date is January 1, 2024. It can be found in California Probate Code Section 16600 – 16632.
- The trustee of such trust is called a "directed trustee". The person with the right to direct the trustee is called the "trust director".
- The "power of direction" includes a power over investment, management, or distribution of trust property or other matters of trust administration.
- The "power of direction" does not refer to a power of appointment, a power to appoint or remove a trust director, or the power of a settlor to revoke or modify a trust, or a beneficiary's power if it affects the beneficial interest of the beneficiary.

CALIFORNIA'S DIRECTED TRUST STATUTE

- A power of direction also does not include a power that the trust says is held in a nonfiduciary capacity, and the power is required to be held in a nonfiduciary capacity to achieve a settlor's tax objectives under the Internal Revenue Code (i.e., safe harbor for grantor trust powers such as the power to replace trust assets with assets of equal value).
- A directed trustee must take reasonable action to comply with the trust director's exercise or nonexercised of the power of direction.

CALIFORNIA'S DIRECTED TRUST STATUTE

- Except for willful misconduct, a directed trustee is liable only for its own breach of trust in executing a direction and not for the trust director's breach of trust in exercising or not exercising the power of direction.
- The act applies to trusts, wherever created, that have as their principal place of administration the State of California. For example:
  - Where a trustee is a resident of or has its principal place of business in California.
  - Where the trust director is a resident of or has its principal place of business in California.
  - All or part of the administration occurs in California.
- Unless the trust provides otherwise, trust directors act by majority rule. Different than trustees, who must act unanimously.

CALIFORNIA'S DIRECTED TRUST STATUTE

- Unless the trust provides otherwise, a trust director has the same fiduciary duties when acting or not acting that a trustee with the same authority would have.
- The trustee must take reasonable action to comply with the direction of the trust director, unless by complying the trustee would be engaging in willful misconduct.
- A directed trustee with reasonable doubt about its duties may petition the court for instructions.
- A release by a trust director given to a trustee or another trust director is not effective if:
  - Breach involved the trustee or other trust director's willful misconduct.
  - At time of release trust director unaware of material facts re breach.
  - Release was induced by improper conduct of trustee or other trust director

CALIFORNIA'S DIRECTED TRUST STATUTE

- The trust director does not have the duty to monitor a trustee or another trust director *or* to give advice to a settlor, beneficiary, trustee, or another trust director concerning an instance in which the trust director might have acted differently than a trustee or another trust director.
- A report or accounting has the same effect on the limitation period for an action against a trust director for breach of trust that the report or accounting would have in an action for breach of trust against a trustee in a like position and under similar circumstances.
- The trust director must accept the position in the same manner as a trustee, is entitled to reasonable compensation as a trustee is, can resign or be removed in the same manner that a trustee can (subject to different provisions in the trust instrument).

CCA 202352018

- This CCA was published December 29, 2023.
- The facts were that a grantor trust was formed years prior. The trustee petitioned the court to add a tax reimbursement provision for the grantor. The beneficiaries consented to the modification. After notice of the hearing was given to the trust beneficiaries, the court granted the order.
- The CCA says that if the tax reimbursement clause had been in the trust there would have been no gift if the trustee exercised his discretion to reimburse the grantor, relying on Examples 2 and 3 of Revenue Ruling 2004-64.
- Here, however, because the beneficiaries consented to the petition to modify they had effectively made a gift.

CCA 202352018

- IRS also noted that even if beneficiaries didn't consent, if they had failed to object to the petition they would have made a gift as well.
- IRS acknowledged that the gift might be difficult to value, but said donor beneficiaries nevertheless cannot escape gift tax on the basis of such difficulties in valuation. In its summary of relevant law, the CCA cites to Treasury Regulation Section 25.2511-1(e), which provides that if a donor's retained interest in the trust is not susceptible of valuation under accepted principles, the gift tax is applicable to the entire property subject to the gift.
- If IRS really believes that allowing a modification of other than administrative provisions of a trust to occur without objecting results in a gift by the trust beneficiaries, then:

CCA 202352018

- Does decanting from one trust to another where the beneficiary's interest is reduced result in the imposition of gift tax (especially where, for example, state law like California requires notice to the beneficiary of the intent to decant)?
- Even if notice of decanting isn't required, should the trustee of the new trust created through the decanting process file a trustee accounting, have the beneficiaries made a gift by not objecting to the trust accounting? If so, was the gift made years earlier at the time of the decant even though the beneficiaries didn't find out about it until the accounting petition was filed and notice mailed to them? If gift tax were due in that circumstance, is it fair that penalty and interest would apply?
- Should beneficiaries always file objections in a court proceeding to modify a trust? What if the judge approves the modification over the objection, is there a gift then? How strenuously must the beneficiary object in court?

CCA 202352018

- For now, perhaps moving forward with decants or trust modifications that impact who benefits from the trust should be put on hold until this gets sorted out?
- What is the binding nature of a CCA? From the IRS website:
- "Chief counsel advice is an umbrella term that encompasses any written advice prepared by any National Office component of the Office of Chief Counsel or division counsel headquartered in Washington and issued to IRS counsel or field office employees that conveys a legal interpretation or IRS counsel position or policy regarding a revenue provision." (IRS Guidance 1980-2003: An Ever-Changing Landscape Notes, Tax Notes)

CCA 202352018

- "Chief Counsel Advice (CCA) materials are written advice or instructions prepared by the Office of Chief Counsel and issued to field or service center employees of the IRS or Office of Chief Counsel." (IRS Website)
- "IRC § 6110(i)(1)(A) defines CCA as written advice or instruction, under whatever name or designation, prepared by any National Office component of the Office of Chief Counsel that A. Is issued to Field or Service Center employees of the Service or Field employees of the Office of Chief Counsel, and B. Conveys any legal interpretation of a revenue provision, any Service or Office of

CCA 202352018

….Chief Counsel position or policy concerning a revenue provision, or any legal interpretation of State law, foreign law, or other Federal law relating to the assessment or collection of any liability under a revenue provision. CCA includes both taxpayer specific and nontaxpayer specific advice." (Definition of Chief Counsel Advice, IRM § 33.1.3.1.1)