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Steve Leimberg's Estate Planning Email Newsletter - Archive Message #3092

Date: 22-Jan-24

From: Steve Leimberg's Estate Planning Newsletter

Subject: Mary E. Vandenack, Joy Matak & Martin M. Shenkman: Notes from the 58th Heckerling Institute on Estate Planning, Part 1 of 5

The **58th Heckerling Institute on Estate Planning** was held January 8 through January 12, at Marriott World Center in Orlando, Florida. Members should click this link to review the meeting agenda. The Heckerling Institute on Estate Planning covers a range of topics for estate planning professionals, including practical pointers that will assist practitioners whether their clients are high net worth individuals or more moderate net worth clients.

Mary E. Vandenack, **Joy Matak** and **Martin M. Shenkman** attended the Heckerling Institute on Estate Planning and agreed to share their notes. Because of the length of the proceedings and the detailed notes, the notes are being separated into five parts and will be published as a series.

Mary E. Vandenack, J.D., ACTEC, CAP®, COLPM®, Accredited Estate Planner (Distinguished) is a partner in the Omaha office of **DUGGAN BERTSCH, LLC**. Mary is a highly regarded practitioner in the areas of tax, trusts and estates, private wealth planning, asset protection planning, business exit and succession planning, and philanthropic strategies. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax-exempt organizations. Mary is a member of Entrepreneurs Organization. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves on Council. Mary is a member of the American Bar Association Law Practice Division where she currently serves as Chair. Mary has been named to ABA LTRC Distinguished Women of Legal Tech, received the James Keane Award for e-lawyering, and serves on ABA Standing Committee on Information and Technology Systems. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law and process

automation. Mary hosts a podcast called Legal Visionaries. https://maryvandenack.com/podcast/

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in New York who concentrates on estate planning. He is the author of 42 books and more than 1,400 articles. He is a member of the NAEPC Board of Directors (Emeritus), served on the Board of the American Brain Foundation, the American Cancer Society's National Professional Advisor Network, Weill Cornell Medicine Professional Advisory Council, and is active in other charitable organizations.

Joy Matak, JD, LLM is a **Partner** at **Avelino Law.** She has more than 20 years of diversified experience as a wealth transfer strategist with an extensive background in recommending and implementing advantageous tax strategies for multi-generational wealth families, owners of closely-held businesses, and high-net-worth individuals including complex trust and estate planning. Joy provides clients with wealth transfer strategy planning to accomplish estate and business succession goals. She also performs tax compliance including gift tax, estate tax, and income tax returns for trusts and estates as well as consulting services related to generation skipping including transfer tax planning, asset protection, life insurance structuring, and post-mortem planning. Joy presents at numerous events on topics relevant to wealth transfer strategists including engagements for the ABA Real Property, Trust and Estate Law Section; Wealth Management Magazine; the Estate Planning Council of Northern New Jersey; and the Society of Financial Service Professionals. Joy has authored and co-authored articles for the Tax Management Estates, Gifts and Trusts (BNA) Journal; Leimberg Information Services, Inc. (LISI); and Estate Planning Review The CCH Journal, among others, on a variety of topics including wealth transfer strategies, income taxation of trusts and estates, and business succession planning. Joy recently co-authored a book on the new tax reform law.

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NOTES:

“Comments” are the authors’ observations and not those of the speakers.

PLANNING FOR MODEST ESTATES: PRACTICAL TOOLS

Presenters: Mickey R. Davis; Melissa J. Willms. Mickey R. Davis is a partner in the law firm of Davis & Willms, PLLC in Houston, Texas. Melissa J. Willms is a partner in the law firm of Davis & Willms, PLLC in Houston, Texas.

General Considerations

- 2026 exemption drops from $13,610,000 in 2024 (inflation adjusted in 2025) to half that perhaps about $7.2 million.

- Be cautious as clients may have a mismatch between GST and regular exemption amounts remaining.

- Unlimited marital and charitable deductions remain for these estates.

- Portability is permanent.

- Income tax considerations are important. For trusts the highest tax bracket is reached at only $15,200 of trust income. This contrasts to about $600,000+ of income before individual taxpayers reach maximum bracket. Comment: Practitioners should endeavor at the planning and drafting stage to incorporate a broad class of beneficiaries to facilitate later income tax planning. Even if the trust is a grantor trust at inception, it will not be at some point, so income tax planning will likely become important. Remember that if a charitable beneficiary is not included in the original

document, it may not be possible to add one later. the. Further, as discussed later in the Institute, the recent CCA may make modification of trusts to adjust planning options potentially more difficult.

Spend Time on Client Motivations and Objectives

- What is total net worth? Asset mix.

- What are client spending habits/growth expectations? Comment: This point is vital for the “moderate wealth” clients the speakers discussed. While some of these client may wish to use exemption before the end of 2025, do those clients really understand their financial status and budget for making completed gifts as part of an estate plan? The speakers suggested running Monte Carlo simulations to help clients gain a realistic understanding of what their future with and without various levels of gifts are?

- What are client key concerns?

- Consider age of client and capacity.

- Consider and discuss marital history and agreements. If family is blended, spend time discussing where any wealth has been accumulated and desires about how it is to be allocated during life of both, survivor, and after both pass away. Comment: while there is so much attention given to differentiating SLATs for purposes of the reciprocal trust doctrine, the differences in distribution rights and standards between the two trusts could be critical to what happens if there is a later divorce. This could be essential for blended families, particularly for those people in 2nd and subsequent marriages, which might be more likely to end in divorce than first marriages.

- What are client occupations and exposure to litigation?

- Are clients philanthropic?

- Are there out of state beneficiaries? Foreign beneficiaries? Foreign assets?

- How much control is desired by clients?

Using Revocable Trusts

- Consider avoiding probate. In some states, failure to avoid probate has become close to being considered malpractice.

- Revocable trusts cover incapacity planning and replace need for conservatorship and possibly guardianship. Comment: Kudos to the speakers for emphasizing this often overlooked point. Especially for clients facing chronic illness, disability or challenges of aging, creating revocable trusts can be a vital step. Consider incorporating one or more of: an institutional trustee or successor trustee, trust protector, mandated periodic evaluations by an independent care manager, or other steps to safeguard vulnerable clients.

- Fund revocable trusts and be sure there are no conflicting TODs, PODs.

- IRAs and qualified plans do pass by beneficiary designation. Consideration should specifically be given to whether trust should be beneficiary rather than individuals. SECURE Act 2.0 and state laws regarding protection of inherited IRAs have changed the landscape. Discuss asset protection vs. tax savings and determine which objectives prevail.

Annual Gifts Pros/Cons

- Comment: Annual gifts should not be done just because they have been done historically. Be deliberate.

- Power of annual gifts invested over time can be significant.

- For some clients even in the moderate wealth range it may be simpler to make a single gift to a trust instead of making annual gifts year after year.

- For many moderate wealth clients, the cost of having a gift tax return prepared may dissuade them from larger gifts in favor of simpler annual gifts.

Charitable Giving

- Cash gifts are easy.

- Consider substantiation rules for non-cash giving. More substantiation is required for non-cash gifts in excess of $250.00.

- Donor advised funds have become popular charitable giving tools for those of modest wealth. Donors can take a charitable contribution for gits to donor advised fund.

- Some clients like private foundations. Gifts are limited to a smaller percentage of adjusted gross income and 5% annual distributions are required.

- New rules regarding donor advised funds encourage looking more closely at private foundation options.

Portability – Trusts Compared to Direct Giving

- Portability allows surviving spouse to inherit ("port") unused exemption of first deceased spouse and use in surviving spouse estate.

- One issue is that the deceased spouse unused exclusion (DSUE) does not inflate. If Spouse 1 dies and $10m of assets pass directly to surviving spouse and the value of the assets inherited by Spouse 2 doubles before Spouse 2 dies, Spouse 2 would be limited to the DSUE calculated as of Spouse 1's death and the appreciation would be potentially taxable in Spouse 2's estate. On the other hand, if those same assets had been placed in a credit shelter trust, the entire amount would have been excluded from estate tax at death of Spouse 2.

- When surviving spouse dies, DSUE of predeceased spouse applies first. Portability only applies to last deceased spouse.

- Note that a non-citizen, non-resident spouse cannot use DSUE but they may still want to preserve the DSUE in the event that the non-resident spouse becomes a US citizen.

- Tax apportionment language is extremely important in the context of DSUE. Consider where transmission expenses might be applied and whether there is a benefit to using them to reduce the marital deduction in order to get an income tax benefit.

- DSUE can be elected with 5 years of first spouse's death if below threshold by filing a pure portability return. Rev. Proc. 2022-32. Comment: Practitioners, in all disciplines, should consider sending the client an email or other written communication anytime they become aware of the death of a spouse, advising about portability deadlines and requirements. Clients, especially on the first spouse's death, and especially if they view the estate as either simple or small, may not get the professional help they need to address portability among other issues. Given the worsening malpractice risks it may be best to document this communication.

- Portability and trust/no-trust planning options should be specifically discussed with clients:

    - Direct transfers to spouse do not have asset protection for surviving spouse and there is no assurance to first deceased spouse regarding ultimate disposition. (Surviving spouse can

pass all assets to new spouse and disinherit children from earlier marriage.)

- Can bequeath to assets to a QTIP and use portability. Funding a trust and benefiting from the DSUE are not mutually exclusive.
- DSUE can be lost on remarriage.
- There is no portability of GST exemption.
- Note that DSUE should be considered even if trust planning is used.

- Some assets don't work well with trust planning: S corporations; some other pass-through entities; Qualified Plan Accounts. In an estate consisting entirely of these assets, an approach other than trusts may make sense; however, there are trusts that work for these assets. Thus, revisit objectives, pros and cons.

Spousal Lifetime Access Trusts ("SLATs")

- The idea is to use up the excess or bonus exemption above what ½ the exemption will be in 2026. While client would be uncomfortable gifting away large amount but may get indirect benefit from the trust.
  - Comment: Premature death (and divorce which is discussed below) should all be considered. Life insurance may be used to protect the settlor spouse from premature death. Financial forecasts should be used to illustrate potential outcomes, tax burn, etc. Caution should be exercised in what types and amounts of "indirect" benefit the settlor spouse may obtain. Practitioners should be cautious about what the put in writing in regards to benefits the settlor spouse may obtain. Consider naming a trustee in a DAPT jurisdiction and qualifying the trust as a DAPT to provide a backstop if the indirect benefits are challenged by a creditor or the IRS.

- Consider who you represent. Most practitioners usually represent both spouses.

- Divorce. Settlor may lose access and under grantor trust rules repeal of Sec. 682 in 2017 Tax Act the settlor will remain taxable on SLAT income. Consider the impact on each spouse if they get divorced the next day. If the clients are worried about divorce, why are they doing a plan?

- Comment: Wealthy clients and/or well-educated clients may face a divorce rate that is perhaps about half of that of other clients. On the other hand, the only cohort of people for which divorce rates continue to rise are seniors, the so-called gray divorce issue. Since much of estate planning focuses on clients over 50-60 those may well be the clients most likely to divorce.

- Do not use gift splitting if spouse is beneficiary of the trust.

- Reciprocal SLATs. *Estate of Grace*. Trusts should not be identical But rather substantively different. There are no bright line rules. Economics should be materially different between the trusts. Some try to do a SLAT and a dynasty trust without spouse as beneficiary, but they acknowledge that moderate wealth clients are not comfortable doing that.

- Step transaction doctrine under the *Smaldino* Case. What should you do if starting with separate property funds, e.g. inherited funds. What if assets are gifted from moneyed spouse to the non-moneyed spouse who then funds a trust. *Smaldino* was not a SLAT case but alerts us to those step-transaction issues.

    - Comment: *Smaldino* was also a bad facts case but looking at step-transaction doctrine is critical and speakers are right to point this at as so much focus is given to the reciprocal trust doctrine and seemingly less to the step transaction doctrine. In *Smaldino* the husband transferred entity interests to the wife who then made a gift to a trust the next day that only benefited the husband's children from a prior marriage. The operating agreement for the LLC given was never updated to reflect the wife as owner. The Form 1065 forms K-1 were never issued to the wife for the day she supposedly owned and interest. The list of foot faults in *Smaldino* is quite long. Just as with the reciprocal trust doctrine as noted above, there are no bright line rules. This will become more of an issue the closer we get to 2026 and underscores the need to start planning early in order to build enough time between planning transactions.

Upstream Planning

- Consider the possibility that a parent or senior generation has an exemption that client might want to capture. A general power of appointment can be given to the parent in a trust. Contrast the GPOA approach to giving an asset outright to a parent, in which case, the asset would be included in the estate of the parent and if parent lives for 1 year + 1 day, Sec. 1014(e) is avoided and a basis adjustment is available. However, the child donor has no control. Instead, the child

sets up a grantor trust to benefit child's descendants and gives a general power of appointment in the trust to the parent. The GPOA can be narrow. For example, the GPOA could allow the parent to appoint assets to a creditor with the consent of another person up to her remaining exemption. There is no need to inform the parent of the existence of GPOA. But note that parent could exercise the GPOA, putting the assets potentially at risk.

- Comment: Consider the following as possible steps to enhance or differentiate a GPOA plan:

- Consider corroborating that the intended powerholder has legal capacity when the grant of the GPOA is made, although this appears to be unnecessary based on several of the cases on GPOAs. Nonetheless, several authorities relied on for GPOA planning results have fact patterns where the decedent had capacity when the power was granted. If the powerholder does not have capacity, perhaps the GPOA could expressly state that an agent under a power of attorney or guardian for the powerholder could exercise the GPOA on behalf of the powerholder, if the donor were comfortable with that.

- Consider the possibility of making the powerholder a beneficiary of the trust and perhaps of even making distributions to the powerholder. That, as in the *Freeman* case might demonstrate knowledge of the trust's existence.

- Consider giving notice of the existence of the GPOA to the powerholder. This might be accomplished by verbal communication, although transmission in a manner that the receipt can be acknowledged might be preferable. This could include sending a copy of the trust agreement via certified mail return receipt to evidence receipt. Perhaps an e-signature on a document acknowledging receipt might suffice. Perhaps emailing the instrument creating the GPOA with a read receipt may be adequate. Perhaps, for existing GPOAs for which no notice has been given, practitioners might discuss with the client the pros and cons of giving notice to the powerholder now, or if the powerholder is incapacitated to the agent under the powerholder's durable power of attorney.

- Consider explaining to the client that there are uncertainties in the law as to the assured inclusion of a GPOA in the powerholder's estate to cause estate inclusion, that most or all authorities on the issue occurred when the tax laws were quite

different than the current free-basing environment, and that the IRS or a court might argue the position in the Finlay case.

Other Techniques

- GRAT. The benefit of a grantor retained annuity trust for moderate wealth clients is the annuity or return of funds plus the 7520 rate. A GRAT for moderate wealth clients might serve as a type of estate freeze.

- QCD - qualified charitable distribution. This is permitted at age 70.5 not 72. The distribution to charity never shows as AGI, which can have many tax benefits for a client, even one of modest means. A couple gets $30,700 standard deduction so may never get a charitable contribution deduction. Instead of taking RMD, such client can make a qualified charitable distribution to a client by having the IRA custodian send the money directly to charity. Absent this strategy, the RMD would have been income and the client may not receive full benefit of the charitable deduction. In addition, by keeping the AGI lower, a client with medical expenses may be able to get a deduction for medical expenses that is greater than they would have gotten otherwise. In addition, a lower AGI may save clients money on Medicare premiums.

Testamentary Trust Plan/Options

- Comment: The summary the speakers provided of various trust options for structuring a dispositive plan is also a good way for practitioners to protect themselves by using their discussion as a checklist of options to offer clients. In that way, options are offered and the clients can select which option they wish to pursue.

- Bypass Trusts may still make sense for some of the following reasons:

    - A credit shelter trust provides asset protection.

    - You can have beneficiary as trustee and still have creditor protection also protection from divorce from a future spouse.

    - Consider implications of surviving spouse remarrying.

    - Income shifting benefits of bypass trust as can sprinkle income to surviving spouse, children and grandchildren (whoever is named as a beneficiary of the CST) many or even all of whom may be in lower income tax brackets then the trust.

- For special needs beneficiaries trusts can protect assets to protect government benefits by incorporating a supplemental needs trust.

- Loans can be made instead of a distribution to retain assets in the trust. This can be done as a teaching tool for heirs. Loan heirs money and see how they react.

- Trusts get unlimited charitable income tax deductions so a bypass trust may be a valuable tool for charitable planning but must include charity in the original document to meet the governing instrument rules.

- QTIP

  - All income must pass to surviving spouse. This requirement applies to fiduciary accounting income (“FAI”), not taxable income. There could be a mismatch between the two.

  - Assets held in a QTIP receive a basis step up on second death.

  - Reverse QTIP election can be made to preserve GST exemption.

  - The use of deceased spouse unused exclusion may create ability for surviving spouse to avoid estate tax on surviving spouse’s.

  - You cannot sprinkle income in a QTIP as you can in a bypass trust and cannot have charitable beneficiaries.

- CLAYTON QTIP

  - The CLAYTON QTIP gives the executor the ability to decide whether the trust should be a bypass or QTIP after the first death.

  - To the extent the executor makes a QTIP election, those assets pass to QTIP and to the extent the executor does not make a QTIP election the assets pass to the bypass trust.

  - Surviving spouse should not be the person with the power to exercise the QTIP election of this type. If state law permits, you can have a special executor. If not, name a special trustee in a revocable trust and have surviving spouse be a successor trustee for everything other than the Clayton QTIP election.

- If you make a QTIP election, estate tax is postponed. The portability election preserves exemption. It is important to address who will pay tax on QTIP assets. Those QTIP assets will be stacked on top of the surviving spouse's estate and the QTIP may pass to children from another marriage. The marginal estate tax rate is paid by the QTIP unless the documents provide otherwise. This can be negotiated.

RECENT DEVELOPMENTS 2023

Presenters: Turney Berry, Carlyn McCaffrey and Ronald D. Aucutt. Turney is a partner at Wyant, Tarrant & Combs LLP. Carlyn is a partner at McDermott Will & Emery LLP. Ronald Aucutt is Senior Fiduciary Counsel at Bessmer Trust Company, N.A.

Corporate Transparency Act

- Practitioners may want to get FinCEN Identification Number.

- Comment: The Corporate Transparency Act (the "CTA") requires a Reporting Company to update information about any Beneficial Owner ("BO") within thirty (30) days of a change unless the BO had previously obtained a FinCEN Identification Number. By helping each BO and individual involved with forming an entity obtain a FinCEN Identification Number, practitioners can save Reporting Companies from missing the short reporting window.

- CTA creates a national registry for entities. Any domestic entity created by filing a document with any state Secretary of State and any foreign entity registered to do business in the US is subject to the CTA.

- When do entities need to report?

    - Entities formed in 2024 must report within 90 days of formation.

    - Entities in existence prior to 2024 have until the year end to file. If information changes, entities have 30 days to update.

- Which entities need to report?

    - Reporting Companies: Reporting companies are domestic entities formed by filing with Secretary of State.

    - Common law trusts and general partnerships are formed by private agreements and without filings so they would not have

to report. However, if the partnership owns entities, it will have to report and its Beneficial Owners will have to report. There are exceptions for entities already subject to government supervision, large companies with 20+ employees, $5M of revenue and physical presence in the US, and banks. Private trust companies that are regulated should also be exempt.

    - Foreign entities not registered to do business in the US are not required to report.

    - There are 23 exceptions that apply to entities.

        - Banks and other companies like banks, already subject to federal regulation.

        - Tax exempt entities under 501(c)(3).

        - Publicly traded entities.

- Who is required to report?

    - Reporting Companies must report for Beneficial Owners and Applicants.

    - Beneficial Owners – This term is defined to include "any individual who directly or through any arrangement exercises substantial control or owns 25%." This includes a senior officer, the power to direct the firing of officers, etc.

    - Applicants – For a newly formed entity, this is often the attorney and support staff that filed the formation documents with the Secretary of State.

- What information is required to be reported for Beneficial Owners?

    - Legal Name.

    - Date of Birth.

    - Residential address. Applicants only have to submit their business address.

    - Unique Identifying number. Scanned copies of identification information must be provided. As an alternative, individuals can obtain a FINCEN identifier.

    - Entities can also obtain a FINCEN identifier.

- Company has to provide legal name, tradename, jurisdiction of formation, and federal identification number. Company can also obtain a FINCEN identifier.

- What are the penalties for not reporting?

  - CTA includes $500/day and the possibility of imprisonment for failure to comply.

CCA Number 202352018

- **Rev. Rul. 2004-64** specified that the grantor is not making a gift when the grantor pays income tax on income earned by the trust. If the trustee is **required** to reimburse the grantor, there is a retained interest that will cause inclusion in grantor's estate. If an independent trustee **only has discretion** to reimburse the grantor for taxes owed on income earned by the assets held by a grantor trust, that alone does not cause inclusion in the settlor's estate; however, the power to reimburse when coupled with other factors could result in estate inclusion (e.g., implied agreement).

- Rev. Rul. 2004-64, 2004-2 C.B. 7.

- In **CCA 202352018**, the trust at issue was an irrevocable discretionary trust that provided for distribution of income to child during the child's life and to child's issue per stirpes upon the child's death. Grantor retained a power that made the trust a grantor trust. Neither the trust or state law authorized tax reimbursement. Pursuant to state law the grantor's child and that child's issue consented to a modification to add a tax reimbursement clause. The Chief Counsel noted that the child had no issue at the time. The trustee sought a trust modification that was approved by the child-beneficiary to allow the trust to reimburse the grantor for income taxes arising from the assets in the trust. The IRS concluded that as a result of the modification, there was a gift to the grantor by the beneficiaries.

- A footnote in CCA 202352018 specifically noted that *PLR 201647001* no longer reflects the position of the IRS.

- The CCA did not address how to value the gift. Numerous questions are left open by the CCA result. How do you estimate income? How do you estimate tax to be paid? How can you determine whether a discretionary power will be exercised? How do you apportion the value among the various current and future beneficiaries?

- **Comment**: Many trust companies insist that a beneficiary sign off on any action or otherwise require the family to effectuate a non-judicial modification agreement if feasible to avoid the trustee having to be involved

because of concerns about potential liability. Now CCA 202353018 may make the provision of beneficiary approval potentially problematic in that the IRS may argue for an imputed gift (or some other challenge). Will professional trustees be willing to proceed without sign-offs from beneficiaries? If not, if there is a trust protector or other mechanism to change trustees, the family may just change trustees to one that will proceed without a sign off. If that change is accomplished by a trust protector action or by an independent trustee, there would seem to be no issue. Would there be a different result if the trust protector were a family member or even a beneficiary? What if the change of trustee mechanism gives the beneficiaries by majority vote the right to change trustees. Will changing trustees in those latter situations be argued by the IRS to be equivalent to the beneficiaries approving the decanting? There is another facet to all of this. Let's say that after CCA 202353018, the trustee is willing to decant the trust without any approval or even advance notice to beneficiaries. What about the professionals advising on the decanting? The sign offs by the beneficiaries in the past would also seemed to have negated a beneficiary later objecting after all they had notice and either agreed or did not object. Without that, might this increase the risks of beneficiaries suing the adviser?

- **The panel suggested that perhaps the trustee could have avoided the issue altogether by modifying the trust to change the choice of law provision to a state such as Florida where the law permitted reimbursement if the trust was silent on the issue. In such a case, perhaps the beneficiaries would not be asked to consent to the modification and there may be less opportunity for the IRS to argue that there was a gift by the beneficiaries to the grantor.**

- **Comment**: The most concerning issue with the CCA is how far will the IRS go on this issue. The estate planning professions have grown accustomed to modifying old trusts to improve the terms and protections and other matters. That trend had been appreciated by professionals and clients alike. Given the rapid changes that so many have experienced being able to modify in some way old trusts has proven incredibly helpful. It seems that in light of this CCA that practitioners may need to proceed with more caution when undertaking any trust modification because of the potential for the IRS arguing gifts or other adverse tax consequences have occurred. How far will this CCA concept be taken?

Adequate Disclosure

- Adequate Disclosure is critical to tolling the statute of limitations when filing a gift or estate tax return.

- *Schlapfer v. Commissioner*, T. C. Memo. 2023-65. 6501(c)(9) states that the statute of limitations does not begin to run if no gift tax return is filed, or if the gift is not adequately disclosed on or with the gift tax return. Adequate disclosure of a completed gift on a gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer even if the transfer is ultimately determined to be an incomplete gift. Failure to satisfy adequate disclosure could result in the conclusion that the statute of limitations on the gift tax return never ran in which case the gift is subject to IRS review indefinitely.

- The regulations regarding adequate disclosure specify that a gift will be adequately disclosed if you disclose a description of the transferred property and any consideration received by the transferor; the identity of and relationship between the transferor and each transferee; if the transfer is in trust, you have to disclose the trust's Tax ID No. and a brief description of the terms of the trust, or you can attach the entire trust; you have to have a detailed description of the method used to determine fair market value or you can attach a qualified appraisal; and you need to include a statement describing any position that's contrary to any proposed, temporary or final IRS regulation or revenue rulings that are published at the time of the transfer.

- Historically, these regulations were interpreted strictly by the IRS but that was not the situation in the Schlapfer case.

- In this case, taxpayer filed a 2006 gift tax return. IRS requested information on the Panamanian company which he provided. The brokerage statement showed the portfolio valuation. Two years later, IRS assessed deficiency and the taxpayer took the position that the statute of limitations had run. The Court said the adequate disclosure regulation is a safe harbor and that its requirements are just the requirements to satisfy the safe harbor. The Court concluded that the adequate disclosure requirements could be satisfied by substantial compliance.

- Schlapfer's transfer was a life insurance policy that was funded by a company that was owned by him. Court also addressed whether life insurance policy or stock was transferred. The court concluded that adequate disclosure requirements were satisfied whether the gift was in 2006 or 2007 as disclosure identified enough details to alert the IRS to the nature of the transaction.

- It is noteworthy in this case that the issue arose in 2014 during a review of Schlapfer's participation in an offshore voluntary disclosure program.

- One requirement of adequate disclosure is a description of property. Court noted that Schlapfer provided enough information to satisfy the

requirement by providing information that described the underlying nature of the property. Court accepted “substantial compliance.”

- Another aspect of adequate disclosure is identity of transferees and their relationships. Again, the court allowed substantial compliance because the donor’s mother was named.

- Adequate disclosure also requires identification of the method used to determine the value of the gift. Donor provided detailed financial information identified in the instructions for Form 706. The court concluded the information provided was sufficient to show the IRS how the insurance was valued.

- Comment: Although this case was favorable to the taxpayer and allowed “substantial compliance”, practitioners should generally not rely on substantial compliance. Strict compliance with the regulations is the right practice; however, in the event of an audit of a client under the disclosure rules, *Schlapfer* can be used to support a client who is in substantial compliance.

Connelly v. United States, 2021 WL 4281288 (E.D. Mo. 2021).

- Connelly v. United States, 131 AFTR 2d 2023-1902 (8th Cir. June 2, 2023), aff’g 128 AFTR 2d 2021-5955 (E.D. Mo. 2021), petition for cert. filed (U.S. No. 23-146, Aug. 16, 2023).

- The Connelly brothers entered into a Stock Agreement for the purpose of ensuring continued family ownership of Crown Co. The agreement provided that the survivor had the right to buy the deceased brother’s shares and that the company would buy the shares if the surviving brother did not. The company bought $3.5 million insurance policies on each brother for the purpose of having insurance to fund a redemption upon death.

- Michael died and the surviving brother chose not to purchase the shares so the company redeemed the shares. The surviving brother was also the personal representative of Michael’s estate. He entered into an agreement with Michael’s son to redeem the shares for $3 million. The shares were valued at the agreed upon $3 million on the estate tax return filed for Michael’s estate.

- The Court concluded that the life insurance proceeds received by the company had to be included in the value of Crown Co. despite the fact there was a redemption obligation. Court noted that value of underlying

equity of company was not reduced by the obligation because the life insurance funded the obligation.

- By way of example, consider a company that has a value of $6,000,000. One owner dies. The company receives $3,000,000 of life insurance proceeds. At that point, the company is worth $9,000,000 (the position of the Connelly court). The company pays out $3,000,000 to the estate of the deceased owner. After such payment, the surviving owner has a company worth $6,000,000.

- The court in the Connelly case concluded that the buy-sell agreement did not satisfy the requirements of section 2703. The court noted that to the extent a process to determine valuation was part of the agreement, the process was not followed. The agreement provided for a certificate of value; however, no certificate of value was ever completed. The agreement provided for an appraisal mechanism to value the company if no certificate of value was completed but no appraisal was completed.

- Note that this case was an Eighth Circuit case that concluded differently from an 11th Circuit case, *Blount v. Commissioner*. The US Supreme Court has accepted cert on the *Connelly* case.

- Comment: Some practitioners think the Connelly case is wrong. This author is among those who believe the Connelly conclusion is correct. Ultimately, whether owners use a cross purchase or redemption, in a scenario such as above, the surviving owner receives the benefit of the life insurance and has an increased estate as a result. Consider a cross purchase. Shareholder X owns a policy on Y. Y dies. Company is worth $6 million. X receives $3 million in life insurance proceeds and buys Y's stock from his estate. Y's estate receives $3 million. X has a company worth $6 million. The difference between the redemption and the cross purchase is that by virtue of including the life insurance in the value of the company at the time of the shareholder's death, the value is included in the shareholder's estate at the time of his death. In the event of a cross purchase, the surviving shareholder receives the benefit and has a larger estate but the increase in estate value is not immediately reportable because the shareholder is still alive.

- Comment: An important point in all of this for practitioners is to ensure that owners understand the economics of these transactions and are making a conscious decision. Additionally, work with clients to implement documents rather than just having them prepared. If using a certificate of value approach, consider having an appraiser design a valuation methodology.

- Comment: Practitioners may need to suggest that cross-purchase arrangements be considered to avoid the Connelly issue. Unfortunately, a cross-purchase agreement could be more difficult for some than entity owned insurance where all owners can be certain that the premiums are paid. Further, with a cross-purchase arrangement, if the number of owners increase, an insurance LLC may be needed, which could potentially raise issues similar to Connelly unless the LLC is owned by irrevocable trusts. The cost and complexity of such arrangements would dissuade many if not most clients from pursuing that type of planning.

Tax Affecting: Estate of Cecil v. Commissioner

- T.C.M. 2023-24 (Feb. 28, 2023).

- *Cecil* dealt with the valuation of The Biltmore Company ("TBC") which owns the Biltmore Estate in Asheville, North Carolina. The taxpayers/donors were William (Bill) and his wife, Mary. In 2010, Mary gifted one Class A share to each of her children, Bill and Dini; William gifted Class B shares to separate trusts for the benefit of each of his five grandchildren. The Cecils reported those gifts on a gift tax return and the IRS challenged the valuation. There were two appraisal issues at trial: (1) whether the appraiser could use tax affecting to determine the fair market value of TBC shares; and (2) which valuation approach to apply for a privately held operating company. TBC was an S corporation. In comparing it to C corporations, the appraisers adjusted the earnings for the different tax treatment. All the appraisers agreed on that approach.

    - Tax affecting is appropriate in this case for valuation purposes. Discount was 17.6%. "Tax affecting" refers to the step in the valuation of a closely-held business that seeks to adjust for differences between passthrough entities and C corporations.

    - Net asset value approach was determined to be inappropriate for valuation purposes because the company is not a real estate holding company but is an operating business. The income approach was determined to be the appropriate valuation methodology for this operating business.

    - Substantial discounts were allowed for lack of control, lack of voting rights and lack of marketability.

    - Practitioners should keep in mind that while valuation discounts can work well for our clients in some situations, the IRS can also use them to work against our clients.

- Comment: Practitioners might recommend to clients/appraisers to consider the tax affecting of any pass through entity as well as evaluating which of the appraisal methodologies is appropriate for the particular situation as, perhaps as in *Cecil*, a particular approach that is less favorable, might be rejected.

Assignment of Income Rule: Charities and Charitable Contributions

- Hoensheid v. Commissioner, T.C. Memo. 2023-34 (March 15, 2023)

- Facts. Donor gives stock to a DAF. Donor clearly did not want stock to be given to charity until the donor was 99% sure that the company would be sold. Donor kept telling this to other people when he gave the stock to the DAF. DAF refused to sign documents pertaining to the sale until they actually got the gift. The sale occurred immediately thereafter.

- The Tax Court applied the anticipatory assignment of income doctrine and denied a charitable deduction for a gift to charity quickly followed by a sale. *Hoensheid v. Commissioner*, T.C. Memo, 2023-34 (March 15, 2023). In this case, the owner didn't want to donate the shares until it was likely that a sale would go through because the owner didn't want to have the sale fall through and end up in a minority interest with respect to his partners. At the time the gift was made, a purchase agreement had not been signed but was going to be signed contemporaneously with closing. The only provision remaining for discussion was a non-substantive provision.

- The anticipatory assignment of income doctrine has two prongs.

    - The first is that the donor must give away the property absolutely.

    - The second is that the property must be given away prior to the property giving rise to income by way of a sale.