2022 Delaware Tax Institute

2022: The IRS, Inflation, a Tax on Book Income: An Interesting Year in Review

Presentations on 2022 Income Tax Developments; Estate Planning and Gift Tax Update; Advanced Tax Planning; Ethics

Friday, December 2, 2022

8:00 am–3:45 pm

Widener University Delaware Law School
4601 Concord Pike
Polishook Hall, Room 104
Wilmington, DE 19803

Delaware Law

delawarelaw.widener.edu

Delaware Tax Institute
2022: The IRS, Inflation, a Tax on Book Income: An Interesting Year in Review

Co-sponsored by Widener University Delaware Law School, Estate Planning Council of Delaware, Society of Financial Service Professionals – Delaware Chapter, and the Delaware State Bar Association

Agenda for Friday, December 2, 2022
Polishook Hall, P104

8:30-8:35 a.m.	**Welcome** **Alicia B. Kelly** **Interim Dean and Professor of Law** **Co-Director Family Health Law & Policy Institute** **Widener University Delaware Law School**
8:35-10:05 a.m.	**2022 Income Tax Developments** **Moderator:** **Kathy S. Schultz, CPA, AEP** **Belfint Lyons & Shuman, P.A.** **Panelist:** **Michael D. Kelly, CPA** **Belfint Lyons & Shuman, P.A.**
10:05-10:15 a.m.	**BREAK**
10:15-11:45 a.m.	**Recent Developments in Estate and Gift Planning** **Moderator:** **Daniel F. Hayward, Esquire** **Gordon Fournaris & Mammarella, P.A.** **Panelist:** **Joseph Bosik IV, Esquire** **Gordon Fournaris & Mammarella, P.A.**

11:45 a.m. -12:30 p.m.	**Lunch – Polishook Hall, P103**
12:30-1:30 p.m.	**Income Tax Fundamentals for Trusts** **Moderator:** **Jocelyn Margolin Borowsky, Esquire** **Duane Morris LLP** **Panelist:** **Jeremiah W. Doyle, Esquire** **Senior Vice President & Senior Wealth Strategist - BNY Mellon Wealth Management**
1:30-2:30 p.m.	**Advanced Tax Planning for Trusts** **Moderator:** **Jocelyn Margolin Borowsky, Esquire** **Duane Morris LLP** **Panelists:** **Kevin M. Barry, CFP** **Principal & Director of Fiduciary Tax Consulting – Bessemer Trust** **Jeremiah W. Doyle, Esquire** **Senior Vice President & Senior Wealth Strategist - BNY Mellon Wealth Management**
2:30-2:45 p.m.	**Break**
2:45-3:45 p.m.	**Ethics** **Panelists:** **Jessica L. Tyler, Esquire** **Disciplinary Counsel – Office of Disciplinary Counsel** **Kathleen M. Vavala, Esquire** **Disciplinary Counsel – Supreme Court of the State of Delaware**
3:45 p.m.	**Adjourn**

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2022 Delaware Tax Institute Planning Committee

Jocelyn Margolin Borowsky, Duane Morris; John "Jack" P. Garniewski Jr., Family Office Solutions, LLC; Bruce Grohsgal, Widener University Delaware Law School; Daniel F. Hayward, Gordon Fournaris & Mammarella, P.A.; Carol A. F. Perrupato, Widener University Delaware Law School; Kathryn S. Schultz, Belfint Lyons & Shuman, P.A.; W. Donald Sparks II, Richards Layton & Finger, P.A.; Leo E. Strine, The Financial House; and Vincent C. Thomas, Young Conaway Stargatt & Taylor, LLP.

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Course materials will be available for download as a pdf at delawarelaw.widener.edu/delawaretax

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WIFI Access Information as a "Widener Guest"

Guests will connect to the wu-guest network, and choose the option that says "Already have a valid guest login, click here"

Username: DelawareTax
Password: DETax2022

BIOGRAPHIES

Kevin M. Barry, CFP

Kevin Barry is Principal and Director of Fiduciary Tax Consulting at Bessemer Trust. In this role, he is responsible for strategic tax consulting and tax management services for fiduciary and individual clients, and related entities.

Prior to joining Bessemer, Kevin was Senior Tax Associate at PriceWaterhouseCoopers in New York. Before that, he was an assistant vice president at U.S. Trust Company.

He is a former executive member of the Committee of Banking Institutions on Taxation and a current member of the Financial Planning Association.

Kevin earned a B.A. in accounting from Queens College (CUNY). He is a CFP® professional.

JOCELYN MARGOLIN BOROWSKY

Partner, Duane Morris, LLP, Wilmington, DE 19801

Jocelyn Margolin Borowsky, a fellow of the American College of Trust and Estate Counsel ("ACTEC"), practices in the areas of estate planning, estate and trust administration and fiduciary litigation in Delaware, New Jersey, and Pennsylvania. *Sophisticated Estate Planning*. A large part of her practice involves the review of clients' overall estate plans, preparation of wills and revocable trusts, and where appropriate, implementation of sophisticated trusts, such as lifetime spousal trusts, asset protection trusts, life insurance trusts, dynasty trusts, BOLI trusts, DINGs, BDITs, GRATs and IDITs. Ms. Borowsky also works with closely-held family businesses and professionals on issues involving strategic tax and business planning, the use of captive insurance and the creation of private family foundations and represents executives of publicly traded companies and shareholders of privately held companies going public. *Modification and Other Advice on Delaware Trusts*. Ms. Borowsky routinely advises clients with respect to resolving trust administration matters, modifying trusts, structuring new Delaware trusts and transferring existing trusts to Delaware through decanting or other means. As an active participant in state bar statutory drafting committees, she is well versed in the preparation of Delaware directed trusts and in the creation of confidential trusts. Ms. Borowsky also has served as an expert witness in matters involving a Delaware directed trust and an executor's breach of fiduciary duty. *Litigation and Audits*. Ms. Borowsky represents fiduciaries and beneficiaries in trust and estate litigation. She also handles tax controversy matters, including estate and gift tax audits by the Internal Revenue Service and state taxing authorities. She is AV® Preeminent™ Peer Review Rated by Martindale-Hubbell and listed in *The Chambers Guide to the Leading High Net Worth Lawyers*.

Areas of Practice

- Wealth Planning
- Estate Planning
- Estate and Trust Administration
- Fiduciary Litigation

Joseph Bosik IV, Esquire

JOSEPH BOSIK IV is a Director at the Wilmington law firm of Gordon, Fournaris and Mammarella, P.A. Joe received his Bachelor of Arts in Business & Economics from Ursinus College and earned his Juris Doctor, cum laude, from Chapman University, Fowler School of Law, with an emphasis in tax law. He also served as an articles editor for the Chapman Law Review. Joe earned his LL.M. in Taxation at Villanova University School of Law.

Prior to joining GF&M, Joe externed for the Tax Division of the United States Attorney's Office, where he was exposed to a variety of complex tax issues. Joe is a member of the Estates and Trusts, Taxation, and Elder Sections of the Delaware State Bar Association, as well as the Delaware Estate Planning Council and the Wilmington Tax Group.

Outside of GF&M, Joe is on the Board of Trustees of the Cameron Logan Scholarship Fund, a charitable organization that provides tuition offsets for students attending Salesianum School and grants to graduating seniors at Kennett High School.

AREAS OF PRACTICE

Trusts and Estate Planning, Estate Administration, Taxation

BAR ASSOCIATIONS

Delaware State Bar Association

ADMITTED TO PRACTICE

United States Court of Appeals Third Circuit
United States Tax Court

EDUCATION

Villanova University School of Law, Master of Laws (LL.M.) in Taxation
Chapman University, Fowler School of Law, Juris Doctor, *cum laude*
Ursinus College, Bachelor of Arts in Business & Economics

PUBLICATIONS

Estate Planning with a Pre-Emptive Strike (November, 2015, Delaware Banker)

PROFESSIONAL ASSOCIATIONS

American Bar Association, *Taxation and Real Property, Trust & Estate Law Sections*
Delaware State Bar Association, *Estates & Trusts, Taxation (Chair for the 2014-2015 year) and Elder Law (Vice Chair for the 2014-2015 year) Sections*
Delaware Estate Planning Council
Wilmington Tax Group

<u>Jeremiah “Jere” W. Doyle IV, Esquire</u>

Jeremiah W. Doyle IV, Esq., is an estate planning strategist for BNY Mellon's private wealth management group and a senior vice president of Bank of New York Mellon. He provides high net worth individuals and families throughout the country integrated wealth management advice on how to hold, manage and transfer their wealth in a tax-efficient manner. Jeremiah is a co-author, contributing author, author or editor of several estate, tax and trust focused publications. He is a lecturer in the Graduate Tax Program at Boston University School of Law and a fellow of the American College of Trust and Estate Counsel. He formerly served as a member of the Massachusetts Joint Bar Committee on Judicial Appointments, as president of the Boston Estate Planning Council and was a 20-year member of the Executive Committee of the Essex County Bar Association. He is a member of the American Institute of Certified Public Accountants Advanced Estate Planning Program steering committee, a frequent speaker for professional education programs and is quoted in numerous business publications and broadcast outlets.

John “Jack” P. Garniewski Jr., CPA/PFS, CFP, AEP

As the President of Family Office Solutions, LLC, Jack leads seasoned professionals who are responsible for delivering advice and service to a national client base of multi-generational families and business owners. Jack works directly with clients to help manage the multi-dimensional aspects of their family's financial affairs.

Jack and his teams work closely with clients and their advisors to develop and support financial strategies that assist clients in meeting their current needs while planning for long-term goals. For some of his clients, this also means serving as executive director, business manager, advisor, and confidant, as well as developing intergenerational strategies customized to best meet their needs.

Jack has more than three decades of experience in providing advice and overseeing the execution of financially related solutions for wealthy families. This includes the strategic leadership and business management responsibilities associated with oversight of multiple family offices and other entities.

Jack holds an MBA in Taxation from Drexel University and earned his bachelor's degree from Villanova University. Jack is a Certified Public Accountant in Delaware and Pennsylvania. He serves as President of the Board of NAEPC (National Association of Estate Planners and Councils) and as a director on numerous family foundations. He is President of the Board of Directors of the Delaware Art Museum and serves on the Board of Directors for various professional and community committees.

He frequently speaks at Family Office and other related professional conferences locally and nationwide, including The National Association of Estate Planners and Councils, the Society of Financial Service Professionals, the Wilmington Tax Group, the Delaware Tax Institute, the Family Firm Institute, Attorneys for Family Held Enterprise, and the Connex International Strategic Investment Sector Meeting. Born and raised in New Castle, Delaware, Jack currently resides in Chester County, Pennsylvania.

Professor Bruce Grohsgal

Bruce Grohsgal is the Helen S. Balick Professor in Business Bankruptcy Law. He joined the faculty in July 2014.

He previously practiced law for more than 30 years, most recently at the Wilmington, Delaware office of Pachulski Stang Ziehl & Jones, LLP. He has represented debtors, creditors' committees, and trustees in chapter 11 bankruptcy cases and litigation, including the debtors in Solyndra, Global Home Products/Anchor Hocking/Mirro/WearEver, Chi Chi's and Trans World Airlines, the creditors' committees in Freedom Communications (Orange County Register) and Jevic Transportation, the medical benefits retirees' committee in Allied Systems Holdings, Inc., and the chapter 11 trustee in Le-Nature's.

Professor Grohsgal is the Editor-in-Chief of the Norton Journal of Bankruptcy Law and Practice, and of the Norton Annual Survey of Bankruptcy Law, and is the Director of the Institute of Delaware Corporate and Business Law. He was a Senior Fellow at Americans for Financial Reform, Washington, D.C., from October 2012 to January 2013, while on Sabbatical from his former firm, and was the Chair of the Bankruptcy Section of the Delaware State Bar Association in 2008-2009. He has spoken on numerous bankruptcy topics, including "first day" hearings, the sale of a business and other assets in bankruptcy, unsecured creditors' committees, executive compensation, derivatives, repos and financial instruments in bankruptcy, and the discharge of student loans by individuals in bankruptcy.

He received his B.A. from Brandeis University in 1977 and his J.D. from Columbia Law School in 1980, where he was a Stone Scholar.

Daniel F. Hayward

Director
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DANIEL F. HAYWARD is a Director at the Wilmington law firm of Gordon, Fournaris & Mammarella, P.A. Daniel graduated with a Bachelor of Science degree in Chemical Engineering from the University of Delaware. He received his law degree from Villanova University School of Law in 2006, and received his LL.M. in Taxation from the Villanova University School of Law in 2015. He is a member of the Delaware Bar Association, and also a member of the Estates and Trusts Section, of which he served as Chair during 2015-2016. He is a Fellow of the American College of Trust and Estate Counsel.

Daniel's practice focuses on the unique aspects of Delaware trust law including directed trusts, dynasty trusts, asset protection trusts and all aspects of the validity, construction and administration of Delaware trusts. Daniel routinely petitions the Delaware Court of Chancery to represent interested parties in the reformation of trusts and to transfer the situs of certain trusts to the State of Delaware. He also drafts, reviews and comments on Delaware trust agreements for local and out of state clients and provides legal opinions on the validity of trusts under Delaware law, including Delaware dynasty trusts and Delaware self-settled asset protection trusts.

Daniel also represents and advises Delaware corporate and individual trustees regarding trust administration and the legal aspects of their fiduciary roles. His practice also frequently includes representation of Delaware trustees in fiduciary litigation matters, in particular actions in the Delaware Court of Chancery seeking construction of trust provisions or instructions from the Court as to various matters of trust administration.

Daniel resides in Hockessin, Delaware with his wife Stephanie and their three children, Charlotte, Lila and Sebastian.

Areas of Practice:
Trusts and Estate Planning [2]
Fiduciary Litigation [3]
Taxation [4]

Michael D. Kelly, CPA
Principal – Tax & Small Business

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Michael has over ten years of experience focusing on taxes while working with various types of industries including medical practices, optometrists, law firms, franchises, family-owned businesses, and construction companies.

Michael specializes in individual and business taxation, trust and estate taxation, state and local taxation, and nonprofit advisory. He frequently assists clients with their accounting questions and has a strong understanding of QuickBooks and other bookkeeping software. Continuously thinking of creative solutions to minimize taxes for his clients and increase client efficiency are two of the many areas where Michael excels. He also enjoys the challenge of researching uncertain or unusual federal and state income tax issues, including being heavily involved with his clients on the PPP loan and forgiveness application process.

Michael has been published in the Delaware Bankers Association's magazine and has presented tax updates at the Society of Financial Service Professionals and at the Delaware Tax Institute.

Professional Affiliations

- American Institute of Certified Public Accountants
- Delaware Society of Certified Public Accountants
- Estate Planning Council of Delaware
- Wilmington Tax Group

Education

- University of Delaware – Bachelor of Arts Degree in Mathematics Education
- University of Delaware – Bachelor of Science Degree in Accounting
- Villanova School of Business – Masters in Taxation

Community Service

- Wilmington Flower Market – Volunteer

Kathryn S. Schultz, CPA, AEP®
Director – Corporate & International Services

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Kathy specializes in providing intricate tax planning and compliance services for individuals, businesses, guardianships, estates, and trusts and makes her clients feel comfortable by taking the time to explain each situation so they gain an understanding of their financial situation. She frequently works with a diverse network of professionals, including local attorneys, to ensure her client's estate and trust tax matters are properly handled. Kathy is instrumental in the firm's International Services team which assists with tax compliance and accounting services for international businesses and individuals. Kathy also assists clients with corporate service matters for Delaware investment holding companies.

Kathy is often asked to present at client, professional, and business groups about recent tax law changes, domestic and international tax matters, and estate and trust planning.

Professional Affiliations

- American Institute of Certified Public Accountants
- Delaware Society of Certified Public Accountants
- Delaware Tax Institute
  - Board Member (2010 – Present)
- Estate Planning Council of Delaware
- PrimeGlobal – International Tax Special Interest Group
- World Trade Center of Delaware
- Wilmington Tax Group
- Delaware State Board of Accountancy – Past Chair

Education

- University of Delaware – Graduated Cum Laude with a Bachelor of Science Degree in Accounting

Community Service

- Philadelphia Chapter and Board Member of the Delaware Chapter of the National Speleological Society
  - Treasurer of Philadelphia Chapter (2009 – 2015)
- Volunteer for the Delaware Division of Fish and Wildlife for the Department of Natural Resources and Environmental Control

Awards & Recognition

- Recipient of the AICPA and DSCPA's 2011 Women to Watch for Established Leaders award.
- Recognized in "Delaware Today" as a 2012 and 2013 FIVE STAR Wealth Manager

W. Donald Sparks II, Esquire

W. Donald Sparks II, Director of Richards, Layton & Finger, P.A., practices primarily in the areas of estate planning, estate administration, tax-exempt organizations and fiduciary litigation. He received his B.A. degree, *summa cum laude*, from Dartmouth College and his J.D. from Yale Law School where he served as a Senior Editor of the Yale Law Journal. He clerked for Judge Caleb Wright of the U. S. District Court for the District of Delaware. He is a fellow of the American College of Trust and Estate Counsel ("ACTEC"). He is a member of the Real Property and Trusts Section of the Pennsylvania Bar Association and the Tax and Estates and Trusts Sections of the American Bar and Delaware Bar Associations. He is a past chairman of the Delaware Bar Association Section of Taxation, a past Chairman of the Delaware Bar Association Estates and Trusts Section, and a past Chairman of the Estate Planning Council of Delaware, Inc. He is a frequent speaker and author on estates, trusts, and other tax-related topics having appeared for ACTEC, The University of Miami Estate Planning Institute, the Delaware Tax Institute and the Delaware Bankers Association Trust Conference. He has also served as a Board member and officer of numerous charitable organizations, including the Brandywine Conservancy & Museum of Art.

Leo E. Strine, CLU, ChFC, MSFS, MSM

Leo Strine started his career in the financial services industry back in 1975. Until that time, he was a buyer for a major department store in Philadelphia but, with a growing family, decided that he wanted a different career that would give him more independence while working with people. At that time, there were no real financial planners per se. There were stock brokers, insurance agents, accountants and lawyers who did work in helping people with their finances. Leo came into the industry as an insurance agent. After several years, it became evident that in order to help his clients, he had to be more knowledgeable about their finances, their lives, and their financial goals.

Always being a person who believed in education, Leo realized that he needed to acquire knowledge in all of those fields of expertise. So over the years, he acquired his Chartered Life Underwriter (CLU) and Chartered Financial Consultant (ChFC) designations and became a licensed Registered Representative in the security industry. But, he didn't stop there. Leo also earned the formal degrees of Master of Science in Financial Services (MSFS) and a Master of Science in Management (MSM). And with updating his knowledge with continuing education courses, felt confident in being able to help his clients and work with their other advisors in order to fulfill their financial needs and goals.

Leo also believed that he had to give back to his industry. So over the years, he held leadership roles as president in the Delaware Association of Insurance and Financial Advisors, the Society of Financial Services Professionals, Delaware Chapter and the Estate Planning Council of Delaware. And, he still holds memberships in each of those organizations as well as the Wilmington Tax Group.

Leo is an Emeritus member of the Professional Achievement in Continuing Education (PACE) program and served on the national Board of Directors of the Society of Financial Service Professionals.

When not in his office, he enjoys time traveling with his wife, Peggy, of 56 years to their favorite places in Ireland, France, England, Scotland and Amsterdam. And, currently with two grandsons in college, both enjoy making sure they get to see each of their soccer games. As long time soccer fans, the Strines have gone to games in Dublin, Manchester, London, Paris and Glasgow.

Together Leo and Peggy have resided in Hockessin since 1973 and raised two sons who have made us proud with their own accomplishments as Chief Justice of the Delaware Supreme Court and First Vice President of the Federal Reserve Bank of New York.

Jessica L. Tyler, Esquire

Jessica Tyler is currently Deputy Disciplinary Counsel for the Supreme Court of the State of Delaware. Prior to that appointment, Ms. Tyler spent 10 years in private practice where she represented individuals and businesses in the defense of civil litigation involving automobile accidents, premises liability, general liability, and products liability. Prior to private practice, Ms. Tyler served as a judicial law clerk for Judges Buckworth and Conner (retired) in the Family Court of the State of Delaware. She previously was a member of the Delaware Civil Clinic where she worked with Delaware Volunteer Legal Services to assist clients with obtaining Protection from Abuse Orders and custody of their children. Ms. Tyler also interned with the Camden County Prosecutor's Office (New Jersey) and the Pennsylvania Attorney General's Office, Bureau of Consumer Protection. Ms. Tyler is a graduate of Arcadia University and Delaware Law School.

Kathleen M. Vavala, Esquire

Kathy Vavala has been a member of the Delaware, Pennsylvania, and New Jersey state bars for 27 years. She is currently Deputy Disciplinary Counsel for the Supreme Court of the State of Delaware. Prior to that appointment, Ms. Vavala was a Deputy Attorney General for the Delaware Department of Justice, where she headed the Domestic Violence, Child Abuse, and Elder Abuse Unit, the Criminal Division Felony Screening Unit, and served as a senior litigator and mentor in the Criminal, Family, and Fraud Divisions. Ms. Vavala is a graduate of Franklin & Marshall College and Delaware Law School. Previously, she was a judicial law clerk to the Honorable Vincent A. Bifferato, Resident Judge of the Delaware Superior Court and associated with the law firm of Tybout, Redfearn & Pell. Ms. Vavala is an adjunct professor for Delaware Law School and Saint Joseph's University, where she teaches professional responsibility, health care law and finance, biomedical ethics, and advanced legal writing. Ms. Vavala is also a frequent presenter on professionalism, civility, and ethical standards applicable to the legal profession.

YOUNG CONAWAY

Vincent C. Thomas

PARTNER

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Wilmington P: 302.576.3278

When closely-held or public companies seek help in structuring transactions around tax, liability, business succession, and other corporate issues, they call on Vince Thomas to combine sophisticated counsel with sound and practical business judgment. His transactional skills, often in collaboration with the firm's bankruptcy group, are a unique and valuable complement to his long established practice representing institutional trustees and individuals in issues of Delaware trust and alternative entity law.

Adept at explaining intricate legal concepts in laymen's terms, Vince involves clients fully in the transaction process. In deals where a single word can have enormous future consequences, he meticulously presents his clients with every viable option, arming them with the substantive knowledge they need to make solid business decisions.

From the precise drafting of transaction documents to the complex tax planning and re-domestication of out-of-state trusts into Delaware, Vince immerses himself in the details and nuances, protecting his clients from unwarranted exposures as he guides their matters to successful resolution.

FOCUS:

- Counseling companies in complex business transactions, including, mergers, acquisitions, corporate restructurings, and financing transactions
- Counseling distressed companies on tax issues, Delaware corporate governance, and transactional matters
- Representing large businesses with general tax and transactional advice, including stock and asset purchase agreements, LLC agreements, partnership agreements, corporate charter documents and shareholders agreements.
- Combining tax, trust and transactional experience to advise distressed companies with liquidation structures
- Representing institutional trustees in all aspects of the administration of Delaware statutory and common law trusts, including, transfer of trust situs, trust reviews, tax planning, decanting, merger, and petitions in the Delaware Court of Chancery. This includes extensive experience with DING Trusts, Delaware asset

protection trusts, Delaware dynasty trusts, Delaware statutory trusts, liquidating trusts, settlement trusts and other sophisticated tax planning structures.

Practices

- Asset Protection
- Entity Formation and Governance
- Family Office Advisory Services
- Tax, Trusts and Estates
- Business Transactions
- Legal Opinions

Education

- Villanova University Charles Widger School of Law (LL.M.)
    - Tax
- Widener University Delaware Law School (J.D., *magna cum laude*)
    - (2nd in Class)
- University of Delaware (B.S.)

Bar Admissions

- Delaware

Distinctions

- American College of Trust and Estate Counsel, Member
- Named leading Delaware practitioner by Chambers High Net Worth since 2016
- Voted a top Delaware business attorney in the Delaware Today Magazine from 2015 through 2018
- Rated AV Preeminent by Martindale Hubble
- Recognized by *The Best Lawyers in America*®, Trusts and Estates, 2019

Memberships and Affiliations

- Served as the prestigious Wolcott Fellow for the Delaware Court of Chancery
- Served as a full time law clerk to Myron T. Steele, Chief Justice of the Delaware Supreme Court.

Clerkships

- Honorable Myron T. Steele, Supreme Court of the State of Delaware
- Honorable Stephen P. Lamb, Vice-Chancellor, Court of Chancery of the State of Delaware, Josiah Oliver Wolcott Fellowship Law Clerk

YOUNG CONAWAY

Representative Matters

- Successfully argued a $350 million NOL tax issue on behalf of a client in the Bankruptcy Court.
- Assisted clients with the negotiation of substantial DIP financing.
- Structured and negotiated numerous out of court asset sales and liquidations for distressed clients.
- Represented numerous closely held businesses with significant asset sales and purchases, recently including, by way of example:
    - Disposition of 44 grocery stores and 37 pharmacies in the Midwest for a distressed client.
    - Acquisition of a substantial rail transfer station.
    - Sales and acquisitions of automobile dealerships.
    - Acquisition and sales of restaurant franchises.
    - Sale of a $50 million mobile home park.

Publications

August 1, 2018
The Potential Impact of the New Partnership Audit Rules
Trusts & Estates, Vol. 157, No. 8

April 2, 2018
Practical Tips When Filing Bankruptcy Cases Involving Delaware LLCs
CCH Journal of Passthrough Entities, March-April 2018

April 1, 2018
Trust-Owned Businesses and the Potential impact of the New Partnership Audit Rules on Trustees
Delaware Banker, Vol. 14, No. 2

April 1, 2018
Delaware's Modification by Consent Statute
Trusts & Estates, Vol. 157, No. 7

March 2, 2018
Popper and Thomas Co-Author, "How the Federal Tax Law Will Impact Delaware"
Delaware Lawyer

January 24, 2018
Drafting Intentionally Defective Grantor Trusts as Silent Trusts: A Delaware Perspective
CCH Journal of Passthrough Taxation, January-February 2018

May 27, 2016

Delaware Silent Trusts
Delaware Banker Magazine, Vol. 12, No. 2, Spring 2016

February 17, 2015
Modifying Loans for Distressed Debtors: Debt Relief or Tax Trap
Delaware Banker, Vol. 11, No. 1

May 30, 2014
A Trustee's Modification Toolbox: Does it Really Include Non-Judicial Settlement Agreements?
Delaware Bankers, Vol. 10, No. 2, Spring 2014

June 1, 2010
The Creditor and the Insolvent Delaware LLC - Can Fiduciary Duties to Creditors be Contractually Eliminated
Delaware Banker (Summer 2010)

September 1, 2009
Delaware Gross Receipts Tax
CCH Journal of State Taxation, Sept./Oct. 2009

Events

October 24, 2018
Grossman and Thomas Speaking at 2018 Delaware Trust Conference

May 10, 2018
Vince Thomas Speaking at the Big IDEas for Your Business Conference

February 22, 2018
Young Conaway Hosts Tax Seminar, "An Update and Analysis of the New Federal Tax Legislation: What Does It Mean for You and Your Clients?"

November 2, 2017
Partner Vincent C. Thomas and Young Conaway Hosting Senior Executive Symposium

May 5, 2016
Selected Topics in Tax, Trusts & Estates, and Employee Benefits Plus Data Protection Issues and Strategies and Valuation of Environmentally Contaminated Properties

September 30, 2014
"Decanting, Non-Judicial Settlement Agreements, Mergers, Administrative Amendment or Court Petition," Panelist, 2014 Delaware Trust Conference

May 21, 2014

YOUNG CONAWAY

2014 Tax, Trusts and Estates, and Non-Competition Agreements Update

News

November 1, 2018
Delaware Today Magazine Recognizes 17 Young Conaway "Top Lawyers"

November 1, 2018
Vince Thomas Elected Fellow of the American College of Trust and Estate Counsel

August 15, 2018
42 Young Conaway Lawyers Recognized by Best Lawyers in America, with 4 Attorneys Further Recognized as Lawyers of the Year (Wilmington, DE)

July 19, 2018
Partners Richard J.A. Popper and Vincent C. Thomas Recognized By Chambers High Net Worth 2018

January 24, 2018
Vincent Thomas Appointed Chair of the Notice Act Committee of the DSBA Estates and Trusts Section

November 1, 2016
Fifteen Young Conaway Lawyers Named "Top Lawyers" by Delaware Today Magazine; Six Attorneys Received Top Votes in Practice Area

June 23, 2016
Partners Richard J.A. Popper and Vincent C. Thomas Recognized By Chambers High Net Worth 2016

November 2, 2015
Delaware Today Announces 2015 Top Lawyers

COURSE MATERIALS

2022 Income Tax Developments

December 2, 2022

Presented By:
Michael Kelly, CPA
Principal – Tax and Small Business
mkelly@belfint.com

Co-Authors:
Valerie Middlebrooks, CPA
Director – Tax and Small Business
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Karly Laughlin, CPA
Principal – Tax and Small Business
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Certified Public Accountants

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Inflation Adjustments

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Inflation Adjustments - 2023 Marginal Tax Rates

- Rev. Proc. 2022-38

Section 1(j)(2)(C) – Married Individuals Filing Joint Returns and Surviving Spouses	
If Taxable Income is:	The Tax is:
Not over $22,000	10% of the taxable income
Over $22,000 but not over $89,450	$2,200 plus 12% of the excess over $22,000
Over $89,450 but not over $190,750	$10,294 plus 22% of the excess over $89,450
Over $190,750 but not over $364,200	$32,580 plus 24% of the excess over $190,750
Over $364,200 but not over $462,500	$74,208 plus 32% of the excess over $364,200
Over $462,500 but not over $693,750	$105,664 plus 35% of the excess over $462,500
Over $693,750	$186,601.50 plus 37% of the excess over $693,750

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Inflation Adjustments - 2023 Marginal Tax Rates

- Rev. Proc. 2022-38

Section 1(j)(2)(C) – Unmarried Individuals (other than Surviving Spouses and Heads of Households)	
If Taxable Income is:	The Tax is:
Not over $11,000	10% of the taxable income
Over $11,000 but not over $44,725	$1,100 plus 12% of the excess over $11,000
Over $44,725 but not over $95,375	$5,147 plus 22% of the excess over $44,725
Over $95,375 but not over $182,100	$16,290 plus 24% of the excess over $182,100
Over $182,100 but not over $231,250	$37,104 plus 32% of the excess over $182,100
Over $231,250 but not over $578,125	$52,832 plus 35% of the excess over $231,250
Over $578,125	$174,238.25 plus 37% of the excess over $578,125

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Inflation Adjustments - Standard Deduction

- Single:

  2022 $12,950

  2023 $13,850

- MFJ:

  2022 $25,900

  2023 $27,700

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Inflation Adjustments - Annual Gift Tax Exclusion

2002 – 2005	$11,000
2006 – 2008	$12,000
2009 – 2012	$13,000
2013 – 2017	$14,000
2018 – 2021	$15,000
2022	$16,000
2023	$17,000

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Inflation Reduction Act of 2022

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Clean Vehicle Credit – Old Rules

- Credit equal to $2,500 plus a factor of energy propulsion generated from the battery not to exceed $5,000, therefore max credit of $7,500
- Needs to be recharged from external source of electricity (5 Kilowatts hours of capacity)
- Credit phases out after 200,000 vehicles sold (GM and Tesla)

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Definition of New Clean Vehicle

- Original use begins with taxpayer
- Acquired for use by taxpayer and not for resale
- Made by a qualified manufacturer
- Treated as a motor vehicle under the Clean Air Act (bars low speed vehicles from qualifying for credit)
- Gross weight less than 14,000 lbs.
- Propelled by significant extent by electric motor, capacity of 7 kilowatt hours and can be recharged by external source of electricity
- Final assembly in North America

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Clean Vehicle Credit – Significant Changes

- Manufacturer limitation eliminated for vehicles sold after December 31, 2022
- Final assembly must occur in North America – **effective 8-16-2022**
- $3,750 credit for critical minerals requirement and $3,750 credit for battery component – takes effect on the earlier of the IRS issuing guidance or after December 31, 2022
- Critical Minerals and battery components – A minimum percentage of minerals or components used to make the battery need to be extracted or processed in the U.S. or which the U.S. has a free trade agreement, or the components are recycled in North America

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Information that Seller gives to Buyer

- Seller of vehicle furnishes all required information to buyer and IRS
  - Name and identification number of taxpayer
  - VIN number
  - Battery capacity
  - Verification of original use of vehicle
  - Maximum credit allowable to taxpayer
  - For vehicles placed in service after December 31, 2023, the amount paid to a taxpayer who elects to claim the credit at time of sale by transferring it to the dealer

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Fuel Cell Motor Vehicle

- Meets the definition of Clean Vehicle
- Final assembly, battery and mineral requirements
- Power derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel

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Manufacturer Suggested Retail Price Limitation

- Credit is not available for the following:
  - Van, SUV, and Pickups with MSRP greater than $80,000
  - Any other vehicle with MRSP greater than $55,000
- Effective after 12-31-22

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Modified Adjusted Gross Income Limit

- Credit is not allowed when income levels go above:
  - Married filing jointly or surviving spouse - $300,000
  - Head of Household - $225,000
  - Single - $150,000
- Effective after 12-31-22

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Transfer of Credit to Seller

- The taxpayer who acquires a new clean vehicle can elect, on or before the purchase date, to transfer the clean vehicle credit to the dealer who sold the vehicle in return for full payment of the credit amount
- The IRS will make advance payments to dealers in an amount equal to the cumulative amount of the new vehicle credits allowed with respect to any vehicles sold by the dealer for which the election to transfer the credit has been made
- A buyer who has elected to transfer the credit for a new clean vehicle to the dealer and has received a payment from the dealer in return but whose MAGI exceeds the applicable limit discussed above is required to recapture the amount of the payment. The buyer's income tax for the tax year in which the vehicle is placed in service is increased by the amount of the payment received by the buyer from the dealer
- Effective for vehicles placed into service after 12-31-23

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Clean Vehicle Credit – Other Items

- No clean vehicle credit is allowed with respect to any vehicle unless the taxpayer includes the VIN on the taxpayer's return
- *Expiration.* No clean vehicle credit will be allowed with respect to any vehicle placed in service after December 31, 2032

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Credit for Previously-Owned Vehicles

- A qualified buyer who acquires and places in service a previously owned clean vehicle after 2022 is allowed an income tax credit equal to the lesser of $4,000 or 30% of the vehicle's sale price.
- No credit is allowed if the lesser of the taxpayer's modified adjusted gross income for the year of purchase or the preceding year exceeds $150,000 for a joint return or surviving spouse, $112,500 for a head of household, or $75,000 for others.
- In 2024, transfer of credit is allowable
- Credit expires December 31, 2032

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Previously-Owned Clean Vehicle

- A previously-owned clean vehicle is a motor vehicle the model year of which is at least two years earlier than the calendar year in which the taxpayer acquires it
- The original use of which starts with a person other than the taxpayer
- Acquired in a qualified sale, and which generally meets the requirements applicable to vehicles eligible for the clean vehicle credit for new vehicles, or is a clean fuel-cell vehicle with a gross weight rating of less than 14,000 pounds

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Qualified Sale

- A qualified sale is a sale of a motor vehicle by a dealer for a price of $25,000 or less
- First transfer since the Act's enactment to a qualified buyer other than the original buyer of the vehicle

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Qualified Buyer

- A qualified buyer is an individual who purchases the vehicle for use and not for resale
- Not a dependent
  - Children who are (or can be) claimed as dependents by their parents are not qualified buyers, even if they have enough income to have to file a return. It makes no difference if the parent chooses not to claim the child as a dependent, because the dependency deduction is still "allowable" to the parent
- Not allowed a credit during previous three years

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New Credit for Qualified Commercial Clean Vehicles

- New general business credit for qualified vehicles acquired and placed in service after December 31, 2022
- The credit per vehicle is the lesser of:
  - 15% of the vehicle's basis (30% for vehicles not powered by a gasoline or diesel engine) or
  - The "incremental cost" of the vehicle over the cost of a comparable vehicle powered solely by a gasoline or diesel engine
- The maximum credit per vehicle is $7,500 for vehicles with gross vehicle weight ratings of less than 14,000 pounds, or $40,000 for heavier vehicles
- Credit expires December 31, 2032

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Qualified Commercial Vehicle

- The vehicle must be acquired for use or lease by the taxpayer, and not for resale
- It must be manufactured for use on public streets, roads, and highways, or be "mobile machinery" as defined in **Code Sec. 4053(8)**
- The vehicle must have a battery capacity of not less than 15 kilowatt hours (7 kilowatt hours for vehicles weighing less than 14,000 pounds) and be charged by an external electricity source
- Qualified commercial fuel cell vehicles are also eligible for the credit
- Qualifying vehicles must be depreciable property. Only vehicles made by qualified manufacturers, who have written agreements with and provide periodic reports to the Treasury, can qualify

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Extension, Increase, and Modifications of Nonbusiness Energy Property Credit

- Energy efficient building envelope -Qualified energy improvements to principal residence
  - Insulation materials
  - Exterior windows, skylights and doors
  - Certain roofs before 2023
- Residential energy property expenditures
  - Electric or natural gas heat pump
  - Central air conditioner, natural gas, propane or oil water heater or hot water boiler
- New $150 credit for home energy audit
- Please note that qualifying property must meet the applicable standards in the law

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Extension, Increase, and Modifications of Nonbusiness Energy Property Credit

- New rules generally effective after December 31, 2022, though extension of credit applies to property placed in service after December 31, 2021
- Extends credit through December 31, 2032
- Increases credit from 10% to 30%
- Replaces lifetime limit with $1,200 annual limit (previous lifetime limit of $500) or $600 annual limit for certain expenditures like windows that previously had a $200 lifetime limit
- Eliminates necessity to be on principal residence for residential energy property expenditure

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Extension and Modification of Residential Clean Energy Credit

- Before the enactment of the Inflation Reduction Act of 2022, individuals were allowed a personal tax credit, known as the residential energy efficient property (REEP) credit, for
  - Solar electric, solar hot water,
  - Fuel cell
  - Small wind energy,
  - Geothermal heat pump, and
  - Biomass fuel property installed in homes in years before 2024
- For property placed in service after December 31, 2019, and before January 1, 2023, the REEP credit rate (applicable percentage) was 26% and was scheduled to go down to 22% in 2023
- Under the Act, the applicable rate is
  - 30% for property placed in service after December 31, 2021, and before January 1, 2033
  - 26% for property placed in service after December 31, 2032, and before January 1, 2034
  - 22% for property placed in service after December 31, 2033, and before January 1, 2035
- Most items do not have a limit on the credit

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Miscellaneous Energy Credits

- ***Alternative Fuel Vehicle Refueling Property Credit*** – Install property that provides alternative energy to taxpayers. Available for businesses or principal residence ($1,000)
- ***Qualifying Advanced Energy Project Credit*** – Expand or build a manufacturing facility that produces various forms of alternate energy property (sun, wind, geothermal, fuel cells, electric grids, plug-in vehicles etc.)
- ***Advanced Manufacturing Production Credit*** – Production and sale of solar energy components
- ***Clean Energy Production Credit*** – Facilities that produce certain clean energy. Does not favor a particular clean energy
- ***Clean Energy Investment Credit*** – Facilities that produce certain clean energy. Does not favor a particular clean energy

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Miscellaneous Energy Credits

- **New Clean Fuel Production Credit** – Production of low-emissions transportation fuel
- **Certain Green Energy Property Classified as MACRS 5-Year Property** – Some of the above assets, if subject to depreciation, may qualify for 5-year depreciable life
- **New Credit for Zero-Emission Nuclear Power Production**
- **Clean Hydrogen Production Credit** - Clean Hydrogen Production Facility
- **New Income or Excise Tax Credit Allowed for Sustainable Aviation Fuel for 2023 and 2024**

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Miscellaneous Energy Credits – Extensions or Modifications

- ***Extension and Modification of Credit for Electricity Produced from Certain Renewable Sources*** – Production of Renewable Energy
- ***Extension and Modification of the Energy Credit*** – Depreciable property used to generate, distribute, or use certain forms of energy such as solar, geothermal, fuel cells, wind energy
- ***Increased Energy Credit for Solar and Wind Facilities in Certain Low-Income Communities***
- ***Extension and Modification of the Credit for Carbon Oxide Sequestration*** – "Carbon Capture Equipment"
- **Extension of Incentives for Biodiesel, Renewable Diesel and Alternative Fuels**
- **Extension of Second-Generation Biofuel Producer Credit to 2024**
- ***Accelerated Cost Recovery for Green Building Property*** – Energy improvements that result in 25% (previously 50%) reduction in energy costs will provide accelerated deductions for improvement property
- **New Energy Efficient Home Credit** for contractors increased $500, $1,000, $2,500 or $5,000 per home

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Favorable ARPA Premium Tax Credit Rules Remain in Effect for 2023-2025

- A refundable Premium Tax Credit (PTC) is available on a sliding-scale basis for individuals and families who are enrolled in an Exchange-Purchased Qualified Health Plan, and who aren't eligible for other qualifying coverage or affordable employer-sponsored health insurance plans providing minimum value
- Under the American Rescue Plan Act (ARPA) of 2021 a more favorable calculation of the PTC was in effect for the 2021 and 2022 tax years which was set to expire in 2023. Under Pre-Act Law, a taxpayer might have had to spend as much as 9.12% of household income on health insurance premiums in 2023. Under the Act, that amount is capped at 8.5%
- *Income Limit.* The PTC is generally available to individuals with household income between 100% and 400% of the FPL. Under ARPA, individuals with household income above 400% of the FPL were eligible for the PTC for tax years beginning in 2021 and 2022, but not for later years
- The Inflation Reduction Act of 2022 extends the above ARPA rules for three additional years

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Corporate Alternative Minimum Tax

- The Inflation Reduction Act imposes a new 15% corporate alternative minimum tax on the adjusted financial statement income of applicable corporations
- The starting point of the calculation is a corporation's average annual adjusted financial statement income which includes financial statements prepared in accordance with generally accepted accounting principles (GAAP)
- A corporation meets the Income Test if its average annual adjusted financial statement income for the three-tax-year period (determined without regard to loss carryovers) ending with the tax year exceeds $1 billion
- Effective for tax years beginning after December 31, 2022

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1% Excise Tax on Repurchase of Corporate Stock

- The Inflation Reduction Act of 2022 imposes on each "covered corporation" a tax equal to 1% of the fair market value of any stock of the corporation which is repurchased by the corporation during the tax year
- A "covered corporation" is any domestic corporation the stock of which is traded on an established securities market
- Effective for tax years beginning after December 31, 2022

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Proposed Regulations on Secure Act and Other Retirement Items

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Secure Act

- Effective Date 1-1-22
- Refresher on RMD Rules
  - Designated beneficiaries excluding surviving spouses
    - *Eligible* designated beneficiaries such as disabled or chronically ill, minor child of decedent, beneficiary who is within 10 years of decedent's age
      - Decedent passes **BEFORE** RMD date, then balance is distributed over life expectancy of decedent
      - Decedent passes **AFTER** RMD date, then balance is distributed over longer of life expectancy of decedent or beneficiary's life expectancy
    - *Non-eligible* designated beneficiaries
      - Decedent passes **BEFORE** RMD date, then balance is distributed by year 10 (see below)
      - Decedent passes **AFTER** RMD date, then balance is distributed by year 10 (see below)

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Secure Act

- Non-Designated beneficiaries such as charities, estates, non-see-through trusts
  - Decedent passes **BEFORE** RMD date, then 5-year distribution period
  - Decedent passes **AFTER** RMD date, the IRA must be distributed over the decedent's life expectancy
- Spouse rules remain intact –surviving spouse elects to treat IRA as their own
- Can eligible designated beneficiary elect 10-year rule instead of the stretch? Plan documents need to allow it

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Proposed Regulations Clarifications

- 10-Year Rule for *Non-Eligible* Designated Beneficiaries
  - Death **BEFORE** RMDs of decedent begun – No annual distribution required during the first 9 years, but account must be withdrawn in the 10th year
  - Death **AFTER** RMDS of decedent begun, then annual RMDS must be taken **EACH** year until year 10, when remaining balance must be withdrawn
    - May not be detrimental for traditional retirement accounts to utilize tax brackets but not ideal for Roth IRA owners
- Minor children clarified to be younger than 21

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Proposed Regulations Clarifications

- Disabled individuals
  - ***18 or Older*** - The individual is unable to engage in any substantial gainful activity (employment) by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration
  - ***Younger than 18*** - Individual has a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or to be of long-continued and indefinite duration
  - ***Safe Harbor*** - Social Security status can be used as disability determination

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Proposed Regulations Clarifications

- Chronically ill is defined under 7702
  - Unable to perform 2 activities of daily living for a period of 90 days,
  - having a level of disability similar (as determined under regulations prescribed by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability **or**
  - requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment
- Activities of daily living
  - Eating
  - Transferring
  - Dressing
  - Toileting
  - Bathing
  - Continence
- Special emphasis on the need for certification from a licensed health care practitioner as defined in 7702
- IRS wants custodians to be provided with documentation regarding disabled or chronically ill individuals

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Proposed Regulations Clarifications

- Eligible designated beneficiary not more than 10 years younger – use the actual *birth date* instead of *birth year*
- Distributions for surviving spouses inherited IRAs are delayed until 72 (as opposed to 70)

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Notice 2022-53 Delay of RMDs

- Final regulations won't be applicable until 2023
- RMD waived for beneficiaries in 2021 and 2022 for decedents passing away in 2020 2021 whose required beginning date has already commenced

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RMD Tables Updated Beginning 2022

- August 2018, Executive Order 13848 directed IRS to review the life expectancy and distribution tables to reflect updated mortality data
- In general, life expectancy increased, which results in a slower RMD

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Beware of Owning Cryptocurrencies in Retirement Accounts

- Department of Labor issued Compliance Assistance Release No. 2022-01 to “caution retirement plan fiduciaries to exercise extreme care before they consider adding a cryptocurrency option to a 401(k) plan's investment menu for plan participants.”
- Footnote says, “Although this release specifically references "cryptocurrencies," the same reasoning and principles also apply to a wide range of "digital assets" including those marketed as "tokens," "coins," "crypto assets," and any derivatives thereof”
- Warns these investments are speculative, present a challenge for plan participants to make informed investment decisions, contain custodial and bookkeeping concern, valuation concerns, and have evolving regulatory environment
- “When defined contribution plans offer a menu of investment options to plan participants, the responsible fiduciaries have an obligation to ensure the prudence of the options on an ongoing basis. Fiduciaries may not shift responsibility to plan participants to identify and avoid imprudent investment options, but rather must evaluate the designated investment alternatives made available to participants and take appropriate measures to ensure that they are prudent”

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Beware of Owning Partnerships in Retirement Accounts

- A retirement account is exempt from all income taxes except for taxes imposed on unrelated business taxable income (UBTI)
- UBTI is income from activities that are not substantially related to the functions for which the IRA is allowed an exemption from income tax, such as regularly engaging in a business normally carried on for profit
- When an IRA is subject to UBIT (unrelated business income tax), it will require an annual tax filing on Form 990-T assuming the UBTI exceeds $1,000
- Since an IRA is considered a trust for federal income tax purposes, any tax generated on Form 990-T will be taxed at the highly compressed rates associated with trusts

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Estate Updates

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Rev Proc 2022-32

- Estate tax exemption is $12,060,000 million per person
- The deceased spouse's unused exemption (DSUE) can be ported over to their surviving spouse by timely filing Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return for election (Section 2010(c)(5)(A))
- If not timely filed, then a private letter ruling from the IRS would be required in order to port the DSUE to the surviving spouse
- Rev Proc 2017-34, the IRS provided a simplified method to obtain an extension of time of up to 2 years from the date of death to make the portability election as long as the estate was not required to file an estate tax return otherwise
- Rev Proc 2022-32 expanded that extension of time to 5 years after the date of death of the decedent

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Rev Proc 2022-32 Continued…

- In order to make a valid late filing election for portability, the executor filing Form 706 on behalf of the estate must insert at the top of the Form 706 that the return is:

"FILED PURSUANT TO REV. PROC. 2022- 32 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)"

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Proposed Regulations on Estate Tax Deductions (REG–130975–08)

- Would impact the deduction for funeral expenses, administration expenses, and/or certain claims against the estate under section 2053
- Expenses that are paid within 3 years of death would not require present-value discount calculations
- Expenses that are paid after 3 years of death would require present-value discount calculations to be included and disclosed properly

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Passthrough Updates

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Schedules K-2 and K-3

- New reporting exception for Partnerships without (or with little) foreign activity
- To qualify for the exception, the Partnership must notify its partners that the K-3 will not be provided unless the partner requests it (they have a month from notification to request)
- Deadline to provide partners with this notification and be eligible for the exception is January 15, 2023

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IRS Campaigns Related to Passthroughs

- Partnership Losses in Excess of Basis
  - Partners that report flow-through losses from partnerships must have adequate outside basis as determined pursuant to IRC 705 to deduct the losses or else losses are suspended per IRC 704(d) to the extent they exceed the partner's basis in the partnership interest
- Distribution in Excess of Partner's Basis
  - Partners that report distributions from partnerships must have adequate outside basis, as determined pursuant to IRC 731(a), in order to receive liquidating or non-liquidating distributions not subject to gain recognition
- Same campaigns with S-Corporations also

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§754 Election Update

- Under a §754 election, a partnership must adjust the basis of partnership property for certain distributions and for transfer of a partnership interest
- Previously, the election statement had to be signed by a partner and attached to the partnership tax return in order to be a valid election
- Proposed regulations were issued in October 2017 to eliminate the signature requirement
- Final Regulations issued and effective date is August 5, 2022
- However, taxpayers may apply this for taxable years ending before August 2022

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Passthrough Entity Tax – AICPA Tax Executive Letter October 4, 2022

- Notice 2020-75 – state income taxes are deductible when paid
- In an October 4th letter, AICPA makes recommendation
  - State tax is deductible in accordance with passthrough method of accounting
  - Taxpayer is entitled to adopt the recurring item exception
  - Relief when entity level election not available until subsequent year under the state laws

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Rev Proc. 2022-19 - S Corporation Relief Procedures

- IRS will no longer make rulings
  - Commercial contractual agreements, buy-sell agreements, agreements restricting transferability of stock, redemption agreements UNLESS principal purpose of agreement was to circumvent one class of stock
  - IRS will not treat any disproportionate distributions by a corporation as violating one class of stock as long as governing provisions provide for identical distribution and liquidation rights

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Rev Proc. 2022-19 - S Corporation Relief Procedures

- IRS will no longer make rulings *since other relief exists*
  - *Form 2553* fails to include consent of shareholder
    - *Section 1.1362-6(b)(3)(iii)*
    - *Rev. Proc 2013-30*
    - *Rev. Proc 2004-35*
    - *Private Letter Ruling* if unable to use the above
  - *Form 2553* contains inadvertent error with regard to permitted tax year
    - *Rev. Proc 2013-30*
    - *Private Letter Ruling* if unable to use the above
  - *Form 2553 or Form 8869* Qsub election missing signature of an authorized officer
    - *Rev Proc 2013-30*
    - *Private Letter Ruling* if unable to use the above

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Rev Proc. 2022-19 - S Corporation Relief Procedures

- If governing document give rise to different shareholder rights and causes a second class of stock, S Corporation could be in jeopardy
- Relief available when the following conditions are met
  - the corporation has or had one or more non-identical governing provisions;
  - the corporation has not made, and for federal income tax purposes is not deemed to have made, a disproportionate distribution;
  - the corporation timely filed a return on Form 1120-S for each tax year of the corporation beginning with the tax year in which the first non-identical governing provision was adopted and through the tax year immediately preceding the tax year in which the corporation made a request for corrective relief **and**
  - before any non-identical governing provision is discovered by the IRS
- Follow Rev. Proc 2022-19, Section 3.06(2)(c)(ii) – corporate governing provision procedure

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Foreign

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Reminder – Reporting Requirements for US Persons with Foreign Connections

- Foreign Trusts/Foreign Gifts – Form 3520, Form 3520-A
- Foreign Financial Accounts and Assets – FBAR (Fin Cen 114), Form 8938
- Ownership of Foreign Corporations and Affiliates – Form 5471, Form 5472 (Form 965, Form 965-A, Form 8992)
- Passive Foreign Investment Companies – Form 8621
- Foreign Transfers, Disregarded, and Flow-Through – Form 926, Form 8858, Form 8865
- Other – Form 5713 (International Boycott Report)

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FBAR Willfulness Recent Cases

- United States v Schwarzbaum from the Eleventh Circuit (January 25, 2022)
- United States v Schik from the Southern District of New York (March 8, 2022)
- United States v Collins from the Third Circuit (June 6, 2022)
- Bedrosian v United States from the Third Circuit (July 22, 2022)

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FBAR Non-Willfulness Recent Cases

- United State v Boyd from the Ninth Circuit (2021)
  - Non-willful failure to file penalty for tax year 2010
  - Had 13 foreign accounts
  - Is the penalty $10,000 or $130,000 ($10k per account) ?
  - IRS assess penalty per account
  - District court agreed with IRS
  - Ninth Circuit disagreed with IRS
- United States v Bittner from the Fifth Circuit (2021) and Supreme Court (2022)
  - Non-willful failure to file penalty for tax years 2007 through 2011
  - Had 25+ foreign accounts in each year
  - Is the penalty $50,000 ($10k x 5 years) or $2.72 million ($10k per account)?
  - IRS assessed penalty of $2.72 million
  - Fifth Circuit agreed penalty by account
  - Supreme Court TBD

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Other Updates/Reminders/Court Cases

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Student Loan Relief

- August 2022 Actions of Administration
- Loan Forgiveness of:
  - $20,000 for Pell Grant recipients
  - $10,000 for others
- Income Thresholds - $125,000 for single and $250,000 for MFJ and HH
- Must apply by 12/31/2023
- Lawsuits filed challenging authority to forgive
- Other provisions from the American Rescue Plan Act (2021)

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IRC 469 Rentals and SE Tax – CCA 202151005

- Does characterization of activity as "rental activity" under IRC 469(c)(2) determine whether rental income from real estate is excluded from net earnings from self-employment?
  - No. Meeting the definition as rental activity is NOT determinative for SE tax purposes
- Not including real estate dealers, when are rentals of living quarters considered rentals of real estate excluded from SE tax?
  - When no services are rendered to occupants
- But, if services are rendered that are not clearly required to maintain the space in condition for occupancy and "are of such a substantial nature that the compensation for these services can be said to constitute a material portion of the rent", then SE tax is owned on the rental income

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New 1099-K Rules Start for 2022

- American Rescue Plan Act
- Third Party Settlement Organization de minimis filing threshold changed to require reporting if payments exceed $600 for 2022 and are for goods or services
- For commercial transactions penalty for failure to furnish and failure to file 1099-K is $290 each for a maximum of $3,532,500

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Crowdsourcing – IRS FS-2022-20

- Box 1 on 1099-K doesn't necessarily mean that such gross payment are taxable
- General rule – all income is taxable unless an exclusion applies
- Are crowdfunding contributions classified as gifts – contributors detached and disinterested generosity?
- Matching of Form 1099-K reporting and recordkeeping

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Section 1202

- Allows a noncorporate shareholder to exclude 50% of the gain from the sale of qualified small business stock (QSBS) that has been held for five years
  - 75% for stock acquired from 2/18/2009 to 9/27/2010
  - 100% for stock acquired on or after 9/28/2010
- Remaining 50% (or 25%) is taxed at the 28% rate
- Requirements:
  - C Corporation requirement
  - Qualified small business requirement
  - Original issuance requirement

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Section 1202 – Continued…

- Additional requirement details:
  - Stock must be issued after 8/9/1993
  - Gross assets must not exceed $50 million
    - Related corporations of the same parent-subsidiary group are treated as one corporation for this test
  - Two requirements must be met for "substantially all" (not defined) of the shareholders holding period:
    - The corporation must be a C Corporation
    - The C Corporation must satisfy the "active business" requirement. At least 80% of the assets of the corporation must be used in the active conduct of one or more qualified trades or businesses

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Section 1202 – Continued…

- Limitations on excludable amounts, limited to the greater of:
  - $10 million, reduced by the aggregate amount of eligible gain taken into account under Section 1202 for prior tax years attributable to stock in the corporation (cumulative limitation)
  - Ten times the aggregate adjusted basis of QSB stock the corporation issued that the taxpayer sold during the tax year (annual limitation)

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Charitable Contributions – Albrecht V. Commissioner

- Disallowed charitable contribution deductions due to lack of substantiation, per IRC 170(f)(8) for contributions of $250 or more
- Taxpayer donated Native American jewelry and artifacts to a museum
- Taxpayer received a "Deed of Gift" to serve as a contemporaneous written acknowledgment (CWA)
- The IRS disallowed the deduction on the grounds that the de facto CWA did not specify whether anything of value was received by the taxpayer from the donee in exchange for the donation

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Charitable Contributions – Albrecht V. Commissioner – Continued…

- Valid CWS must contain four requirements:
  1. Specify the amount of cash donated or give a description of the property donated
  2. Must state whether the charity provided any goods or services in consideration for the donation
  3. If something of value was given in exchange, a description and good faith estimate of the value of what was given
  4. Must be contemporaneous – must be received from the donee organization on or before the earlier of (1) the date the taxpayer files their return or (2) the due date (including extensions) for filing such return

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Charitable Contributions – Albrecht V. Commissioner – Continued…

- Contribution Substantiation Requirements:
  - Less than $250 – receipt or reliable written records
  - $251 - $500 – Contemporaneous written acknowledgement (CWA)
  - $501 - $5,000 – CWA + Manner and date of acquisition and cost basis (Form 8283 – publicly traded stock excluded)
  - $5,001 - $500,000 – CWA + qualified appraisal (Form 8283 – publicly traded stock excluded)
  - Artwork of $20,000 or more – attach appraisal and color photo
  - More than $500,000 – CWA, attached appraisal

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TC Memo 2016-20

- The corporation, a law firm, had paid annual bonuses to each of its shareholders which managed to zero out taxable income
- The corporation also paid no dividends to its shareholders
- The IRS questioned whether reasonable compensation was being paid to the shareholders
- The court noted the "reasonable investor" test
- The court concluded the firm did not have substantial authority for the position it took that all payments to the shareholders represented deductible compensation rather than dividends representing a return on capital

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Phase-Down of Applicable Percentage of Bonus Depreciation

- 100% for property placed in service 9/27/2017 – 1/1/2023
- 80% for property placed in service during 2023
- 60% for property placed in service during 2024
- 40% for property placed in service during 2025
- 20% for property placed in service during 2026

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Meals Deduction

- 100% deduction for meals provided by a restaurant expires 12/31/2022

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Research and Development Section 174

- Originally introduced under the TCJA
- Specified research or experimental expenditures are no longer currently deductible but must be amortized over five or fifteen years depending on domestic or foreign research
- Appeal was expected and was included in the stalled Build Back Better Act
- May 2022 letter from the AICPA
  - Asks for clarification and examples of research and development costs
  - Concerned over how broadly the IRS will bring indirect costs and overhead into the definition of R & D (like 263A)
  - Additional concerns regarding software costs
- Deemed as a change in accounting method and may require the filing of Form 3115

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Corporate Reporting Transparency Act

- The Anti-Money Laundering Act of 2020, which is part of National Defense Authorization Act for Fiscal Year 2021
- Final guidance issued on 9-29-2022
- Purpose is to crack down on shell companies which have been the vehicle for money launderers, terrorist and criminals
- Create national registry of "Beneficial Owners" and "Company Applicants"
- Certain business entities needs to file information for their beneficial owners
    - Most "small" domestic corporations, limited liability companies or any entity created by filing of a document with secretary of state or similar office
    - A foreign reporting company is a corporation, LLC, or other entity formed under the law of a foreign country that is registered to do business in any state by filing of document with secretary of state or similar office

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Corporate Reporting Transparency Act

- Failure to file/willful false reports
  - Civil monetary penalties of $500 for each day that the violation continues or has not been remedied; and
  - Criminal penalties of not more than $10,000, imprisonment of not more than two years, or both.
- There is a Safe Harbor for persons acting in good faith to correct inaccurate information submitted within 90 days of the inaccurate report

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Corporate Reporting Transparency Act

- Initial reports
  - Certain entities created before 1.1.24 shall file an initial report not later than 1.1.25
  - Any entity created after 1.1.24 shall file a report within 30 calendar days after creation
- Updated reports
  - File within 30 days after the change

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Corporate Reporting Transparency Act

- General exemption for large operating companies
  - Employs more than 20 full time employees in the United States,
  - Has an operating presence at a physical office within the United States; and
  - Filed a Federal income tax or information return in the United States for the previous year demonstrating more than $5,000,000 in gross receipts or sales
- Exemption for publicly traded companies and nonprofits

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Corporate Reporting Transparency Act

- Company Applicant – any individual who files the document that creates the reporting company
- Beneficial Owners
  - Under the rule, a beneficial owner includes any individual who, directly or indirectly, either
    - exercises substantial control over a reporting company, or
    - owns or controls at least 25 percent of the ownership interests of a reporting company
    - Some exceptions include minor children and inherited ownership
- Substantial Control – Service as senior officer, authority over senior officer, or direction, determination, or decision of, or substantial influence over, important matters of a Reporting Company

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Information for Applicant and Beneficial Owner

- Full Legal Name
- Date of Birth
- Business/Home Address
- Identifying number from passport or driver license or another form of governmental ID

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Reporting Company

- Its name
- Any "d/b/a” names
- Business address
- Jurisdiction of formation or registration
- A unique identification number such as a TIN or EIN

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Thank You!

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Estate Planning Update

Delaware Tax Institute

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Treasury Regulations

- Proposed Regulations issued on February 23, 2022 relating to Qualified Plans
  - Required Minimum Distribution ("RMD") for a non-eligible designated beneficiary ("EDB")
    - Classification of EDBs
      - Surviving spouse of the employee
      - A minor child of the employee
        - Age of majority is 21 under the Proposed Regs.
      - A disabled individual (within the meaning of Section 72(m)(7))
        - Under the Proposed Regs., there is a change in definitions.
          - If 18 or older, "the individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration." Prop. Reg. § 1.401(a)(9)-4(e)(4).
          - If under 18, the "individual has a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or to be of long-continued and indefinite duration." Prop. Reg. § 1.401(a)(9)-4(e)(4).
          - The individual is disabled within the meaning of 42 U.S.C. § 1382c(a)(3).
        - The Proposed Regs. require documentation of disability, i.e., certification from a licensed health care practitioner.
      - A chronically ill individual (within the meaning of Section 7702B(c)(2))
        - The Proposed Regs. require documentation of chronic illness, i.e., certification from a licensed health care practitioner, or certification from a licensed health care practitioner that the individual is unable to perform at least 2 activities of daily living for an indefinite period that is reasonably expected to be lengthy in nature.
      - A individual who is not more than 10 years younger than the employee
      - A designated beneficiary of an employee if the employee died before January 1, 2020 (or January 1, 2022, with respect to governmental plans)
    - RMD Rules – Death Before Required Beginning Date ("RDB")
    - RMD Rules – Death After Required Beginning Date ("RDB")

Treasury Regulations

- Proposed Regulations issued on February 23, 2022 relating to Qualified Plans
  - Required Minimum Distribution (“RMD”) for a non-eligible designated beneficiary (“EDB”)
    - Classification of EDBs
    - RMD Rules – Death Before Required Beginning Date (“RDB”)
      - The entire balance of the plan must be distributed by December 31 of the calendar year that includes the 10th anniversary of the decedent’s date of death.
    - RMD Rules – Death After Required Beginning Date (“RDB”)
      - The entire balance of the plan must be distributed by December 31 of the calendar year that includes the 10th anniversary of the decedent’s date of death; however, in years 1-9 the beneficiary must take annual RMDs based on the beneficiary’s life expectancy.

Treasury Regulations

- Proposed Regulations issued on June 28, 2022 relating to Section 2053
  - Application of Present-Value Principles
    - Current Rules: Generally speaking, deductions for claims and expenses under Section 20.2053-1(a), e.g., funeral expenses, administration expenses, claims against an estate, etc., are limited to the amounts actually paid. However, a deduction is allowed for amounts to be paid, provided that the amount is ascertainable with reasonable certainty and will, in fact, be paid.
    - Proposed Regs.: For claims and expenses not paid on or before the third anniversary of the decedent's date of death, a present-value calculation must be used. The discount rate is equal to the AFR in the month of the decedent's death, compounded annually (between date of death and date of the expected payment).
      - Reasonable assumptions and methodologies are permissible with respect to measuring the time period.
      - Deductions may be adjusted to reflect post-death events.
      - A statement must be attached to the Form 706 showing the computation.
      - For deductions under Section 20.2053-4(b) or Section 20.2053-4(c), the expected date(s) of payment must also be identified in a written appraisal.
  - Interest Expense (Tax and Penalties)
  - Interest Expense (Loans)
  - Appraisal Requirement
  - Deduction for Personal Guarantee

Treasury Regulations

- Proposed Regulations issued on June 28, 2022 relating to Section 2053
  - Application of Present-Value Principles
  - Interest Expense (Tax and Penalties)
    - Current Rules: Interest payable on deferred estate taxes under Section 6161 is deductible once paid (deemed to be necessarily incurred in the administration of the estate).
    - Proposed Regs.: An interest deduction will not be allowed in cases where an underpayment or deficiency is "attributable to an executor's negligence, disregard of applicable rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in § 1.6662-3(b)(2) of this chapter, or fraud with intent to evade tax" (not considered necessarily incurred in the administration of the estate). Prop. Reg. § 2053-3(d)(iii).
  - Interest Expense (Loans)
  - Appraisal Requirement
  - Deduction for Personal Guarantee

Treasury Regulations

- Proposed Regulations issued on June 28, 2022 relating to Section 2053
  - Application of Present-Value Principles
  - Interest Expense (Tax and Penalties)
  - Interest Expense (Loans)
    - Current Rules: Amounts deductible as administration expenses under Section 2053(a)(2) must be actually and necessarily incurred in the administration of the estate, and must be bona fide in nature.
    - Proposed Regs.: "To be a deductible administration expense, interest expense must arise from an instrument or contractual arrangement that constitutes indebtedness under applicable income tax regulations and general principles of Federal tax law. In addition, the interest expense and the loan to which interest expense relates must satisfy the requirement of § 20.2053-1(b)(2) that they are bona fide in nature based on all the facts and circumstances. Further, both the loan to which the interest expense relates and the loan terms must be actually and necessarily incurred in the administration of the decedent's estate and must be essential to the proper settlement of the decedent's estate." Prop. Reg. § 20.2053-3(d)(2). A non-exclusive list of factors to be considered include:
      - The interest rate and terms, including any prepayment penalties, are reasonable given all facts and circumstances and are comparable to an arms-length transaction.
      - The loan is entered into by the executor (acting is said capacity) or the person accountable for satisfying estate liabilities.
      - The lender properly includes paid and/or accrued interest in gross income for federal income tax purposes, particularly if the lender is a family member, related entity, or beneficiary.
      - The loan proceeds are used to satisfy estate liabilities that are essential to proper settlement (including federal estate taxes).
      - The loan term and payment schedule correspond to the anticipated ability to make payments under and satisfy the loan, and the term does not extend beyond what is reasonably necessary.
      - The only practical loan alternatives are (i) to sell estate assets at prices significantly below market, (ii) the forced liquidation of an active trade or business, or (iii) a similar financially undesirable course of action.
      - The loan is entered into when the estate's liquid assets are insufficient to satisfy liabilities, the estate does not have control of an entity with liquid assets sufficient to satisfy estate liabilities, the estate has no power to direct or compel an entity to sell liquid assets, and the estate's assets are expected to generate sufficient cash flow or liquidity to make the required loan payments.
      - The estate's illiquidity does not occur post-death as a result of a testamentary plan to create illiquidity, and the illiquidity does not occur post-death as a deliberate result of the action or inaction of the executor who then had both knowledge or reason to know of the estate tax liability and a reasonable alternative to that action or inaction that could have avoided or mitigated the illiquidity.
      - The lender is not a beneficiary of a substantial portion of the estate, and is not an entity over which a beneficiary has control or the right to compel or direct the making of the loan.
      - The lender(s) are not beneficar(ies) who share of liability under the loan is substantially similar to his or her share of the estate.
      - The estate has no right of recovery of estate tax against, or contribution from, the lender.
  - Appraisal Requirement
  - Deduction for Personal Guarantee

Treasury Regulations

- Proposed Regulations issued on June 28, 2022 relating to Section 2053
  - Application of Present-Value Principles
  - Interest Expense (Tax and Penalties)
  - Interest Expense (Loans)
  - Appraisal Requirement
    - Current Rules: In general, estates may deduct only amounts that are actually paid in satisfaction of a claim. Subject to certain requirements, there are, however, exceptions for claims and counterclaims in a related matter and for unpaid claims not exceeding $500,000. One requirement is that the value must be determined by a "qualified appraisal" that is performed by a "qualified appraiser" within the meaning of Section 170.
    - Proposed Regs.: The current value must be set forth in a written appraisal that adequately reflects the current value of the claim at the time the federal estate tax return is prepared. The appraisal must:
      - Adequately reflect post-death events occurring prior to the date on which a deduction is claimed.
      - Report, consider, and appropriately weigh all relevant facts and elements of value known or reasonably determinable, e.g., facts relating to the claim, litigation risks, current status of the claim, and procedural history.
      - Account for post-death events reasonably anticipated to occur.
      - Identify expected date(s) of payment.
      - Explain in detail the methodology and analysis that support its conclusions.
      - Be prepared, signed under penalties of perjury, and dated by a qualified person who is not a family member of the decedent, a related entity, a beneficiary, a family member of a beneficiary or related entity to a beneficiary, or an employee or owner of any of them.
      - Include a statement as to the appraiser's qualifications.
  - Deduction for Personal Guarantee

Treasury Regulations

- Proposed Regulations issued on June 28, 2022 relating to Section 2053
  - Application of Present-Value Principles
  - Interest Expense (Tax and Penalties)
  - Interest Expense (Loans)
  - Appraisal Requirement
  - Deduction for Personal Guarantee
    - Current Rules: In order to be deductible, a claim must represent a personal obligation and must be enforceable against the estate. With respect to a guarantee, it also must have been pursuant to a bona fide agreement in exchange for adequate and full consideration in money or money's worth, i.e., in exchange for the guarantee, the decedent must have received a benefit reducible to a monetary value.
    - Proposed Regs.: The same general rules still apply; however, certain bright line rules also appear to be imposed. In addition, the Proposed Regs. provide that a right of contribution or reimbursement will reduce the deductible amount. Further, a deduction is allowed only to the extent that the debt is not accounted for in computing the gross estate.
      - The guarantee of an entity's debt in which the decedent had an interest at the time of the guarantee satisfies the adequate and full consideration requirement if, at the time of the guarantee, the decedent had control of the entity.
      - Alternatively, if at the time of the guarantee, the decedent's maximum liability under the guarantee did not exceed the fair market value of the decedent's interest in the entity, the adequate and full consideration requirement is also deemed to be satisfied.
      - With respect to a guarantee for the benefit of a family member, a related entity, or a beneficiary, the bona fide requirement is determined under Section 20.2053-1(b)(2)(ii).

Revenue Procedures

- Rev. Proc. 2021-45
  - Inflation adjusted amounts for 2023 tax items
  - Lifetime exclusion against estate tax: $12,060,000 (an increase from $11,700,000 in 2021)
  - Gift tax annual exclusion: $16,000 (from $15,000)
  - Gift tax annual exclusion for gifts to non-US spouse: $164,000 (from $157,000)
- Rev. Proc. 2022-38
  - Lifetime exclusion against estate tax: $12,920,000
    - The same increase applies for the lifetime generation-skipping transfer ("GST") tax purposes
  - Gift tax annual exclusion: $17,000
  - Gift tax annual exclusion for gifts to non-US spouse: $175,000
- Rev. Proc. 2022-3 and Rev. Proc. 2022-7
  - Identify domestic and international areas, respectively, for which the IRS will not issue a letter ruling or determination letter

Revenue Procedures

- Revenue Procedure 2022-3 and Revenue Procedure 2022-7
  - Identify domestic and international areas, respectively, for which the IRS will not issue a letter ruling or determination letter
  - Certain items relating to tax consequences of "ING" trusts are excluded
    - In Delaware, these are known as "DING" trusts, which is short for Delaware incomplete-gift, non-grantor trust
    - In this type of trust, the grantor makes an incomplete gift of assets to the trust, so the value of the assets upon the grantor's death is includible in the grantor's estate for federal estate tax purposes upon the grantor's death
    - This type of trust, being a non-grantor trust, is its own income taxpayer separate from the grantor, and the trust files its own income tax return, can take its own deductions/exclusions/credits, etc.

Revenue Procedures

- Revenue Procedure 2022-10
  - Creates a "fast track" pilot program for corporate tax private letter rulings (PLRs)
  - Useful for more straightforward transactional rulings

Private Letter Rulings

- On July 1, 2022, the IRS increased the cost to file a request for a PLR from $10,000 to $12,500

- PLR 202202006
  - IRS granted an extension of time for a Trustee to notify the IRS that s surviving spouse had become a US citizen

- PLR 202206008
  - IRS approved a judicial modification of a GST grandfathered trust to add a formula testamentary general power of appointment
  - This would enable the remainder beneficiaries or the appointees of the GPOA to receive a step-up in basis at the powerholder's death
  - IRS ruled that this would not affect the GST-exempt status of the trust, and would only cause estate tax inclusion with respect to the appointed assets (the value of which was limited by a formula)

Private Letter Rulings

- PLR 202215015
  - IRS ruled on the GST tax consequences of a trust merger of two trusts
- PLR 202217005
  - IRS ruled on the estate and GST tax consequences associated with a judicial construction of the provisions of a trust
- PLR 202239003
  - IRS ruled on the GST tax consequences of a trust modification that was done due to unanticipated circumstances
- PLR 202216006
  - IRS ruled on the gift, estate, income and GST tax consequences of a judicial modification of trusts
- PLR 202223010
  - IRS granted an executor an extension to make a QTIP election for three marital trusts

California Legislative Proposal

- Resulted from a meeting of the California Franchise Tax Board in early November 2020 – "Legislative Proposal C"
- Taxation of "ING" trusts
  - Delaware is a state that allows for self-settled asset protection trusts in which the grantor of the trust can have a beneficial interest in the trust but still have the trust assets protected from the grantor's creditors as long as the funding of the trust did not constitute a fraudulent transfer
  - Also provides the ability to avoid or defer state income tax for certain states
- For CA residents creating a DING trust, currently it is possible to avoid or defer CA state capital gains/income tax (most often utilized when a sale or liquidation event is anticipated), as long as the trust is structured correctly
  - No CA source income
  - No CA resident fiduciaries (unclear whether this applies to the Distribution Committee members)
  - Any CA beneficiaries must be "contingent"

California Legislative Proposal

- Currently, California mostly confirm to the federal treatment of trusts for income tax purposes, including treating ING trusts as separate legal entities and taxpayers for income tax purposes.
- Proposed legislation would require that the net income from an ING trust's assets be included in the grantor's gross income and subject to CA income tax
  - Essentially, for state income tax purposes the trust is treated as a grantor trust and not a non-grantor trust
  - A very similar approach was taken by NY in 2015 when they passed legislation that effectively ended the use of ING trusts for state income tax purposes
- If passed, would be operative for taxable years beginning on or after January 1, 2022.

California Legislative Proposal

- Where does this leave us when it comes to planning for CA clients?
- If state income taxation is client's primary concern, consider a completed gift trust
  - Non-grantor trust for descendants
  - SLANT
- Proposed legislation would not affect federal income tax treatment of DING trusts
  - "Stacking " QSBS gain exclusions

Possible Future Wealth Transfer Tax Changes

- As a result of the Tax Cuts and Jobs Act, beginning in 2018, the basic exclusion amount was increased from $5,000,000 per person to $10,000,000 per person, as adjusted for inflation.
- Currently, the basic exclusion amount is $12,060,000 per person. Effective January 1, 2023, the basic exclusion amount will increase to $12,920,000 per person.
  - However, if no new legislation is enacted prior to January 1, 2026, the basic exclusion amount will revert to $5,000,000 per person, as adjusted for inflation
- To alleviate concerns related to "clawback," on November 26, 2019, the IRS issued Final Regulations under Section 20.2010-1(c).
  - Because the estate tax and gift tax operate under a unified system, practitioners were concerned with possible negative tax results where a decedent made taxable gifts during a time when the basic exclusion amount had doubled, but died following the sunset of the doubling of the basic exclusion amount.
    - For example, Taxpayer makes a gift in 2022 of $12,000,000, but dies in 2026 when the basic exclusion amount is $7,000,000 (amount assumed).

Possible Future Wealth Transfer Tax Changes

- In essence, the anti-clawback Regulations provide that credit against estate taxes is based on the greater of the basic exclusion amount in effect at a decedent's date of death or the basic exclusion amount applicable to lifetime gifts.
  - Example: "Before 2018, A had never made a taxable gift. In 2018 when the BEA is $11.18 million, A makes a taxable gift of $9 million. A uses $9 million of the available BEA to reduce the gift tax to zero. A dies in 2026. Even if the BEA is lower that year, A's estate can still base its estate tax calculation on the higher $9 million of BEA that was used in 2018." *See* https://www.irs.gov/newsroom/estate-and-gift-tax-faqs

Possible Future Wealth Transfer Tax Changes

- On April 27, 2022, the IRS issued a new Proposed Regulation (Section 20.2010-1(c)(3)) that applies to completed gifts that are includible in a decedent's estate. The following transfers would not be subject to the anti-clawback rules:
  - Transfers included in the decedent's gross estate under Sections 2035, 2036, 2037, 2038, and 2042, regardless of whether any part of the transfer was deductible as a charitable or marital gift
  - Transfers made by an enforceable promise that remain unsatisfied at death
  - Transfers described in Section 25.2701-5(a)(4) or Section 25.2702-6(a)(1)
  - Transfers that would fall within the above categories but for the transfer, relinquishment, or elimination of an interest, power, or property within 18 months of death, whether by the decedent alone or in conjunction with another, or by any other person
    - There are 2 exceptions:
      - Transfers included in the gross estate if the taxable portion of the transfer, as of the date of transfer, was 5% or less of the total value of the transfer
      - Transfers, relinquishments, or eliminations falling within the 18-month rule that were effectuated by the termination of the durational period set forth in the transfer instrument by either (i) the passage of time, or (ii) the death of any person

Possible Future Wealth Transfer Tax Changes

- House Ways and Means budget reconciliation recommendations in 2021
  - Proposes to revert lifetime estate/gift tax exemption to $5 million (adjusted for inflation) on January 1, 2022
  - Assets of a grantor trust would be includible in a grantor's taxable federal estate
  - Grantor trust status would be disregarded for purposes of sales/transfers between a grantor and a grantor trust, causing the recognition of gain or loss upon the sale/transfer
    - This was proposed to apply to grantor trusts created after the date of enactment AND to existing grantor trusts to which a contribution is made after enactment
  - Restrictions on valuation discounts
    - Would no longer be allowed for "passive" investments
- Other possibilities and proposed plans

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A Bunch of Things Estate Planners Need to Know About the Income Taxation of Estates and Trusts

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I normally don't listen to presentations on income taxation of estates and trusts

But when I do, I listen to this one

Agenda

- Basics of income taxation of estates and trusts
- Compressed income tax rates
- Trust accounting income (TAI)
- Distributable net income (DNI)
- Including capital gains in DNI
- Types of trusts
  - Simple
  - Complex
  - Grantor
- Fiscal year end
- Section 645 election
- Section 642(c) – fiduciary income tax charitable deduction

Agenda

- Administration expenses
- Distribution system
  - General rule
  - Tier system
  - Separate share rule
  - Sixty-five day rule
  - Specific bequests
  - Section 643(e) election
- Year of termination – NOLs, capital loss carryover, excess deductions, PALs
- State income taxation of trusts

Income Taxation of Trusts and Estates - Code Outline

- PART I, SUBCHAPTER J
  - Subpart A - Sec. 641-646 - General Rules
  - Subpart B - Sec. 651-652 - Simple Trusts
  - Subpart C - Sec. 661-664 - Complex Trusts and CRTs
  - Subpart D - Sec. 665-668 - Accumulation Distributions
  - Subpart E - Sec. 671-679 - Grantor Trusts
  - Subpart F - Sec. 681-685 - Misc. Rules

- PART II, SUBCHAPTER J
  - Sec. 691-692 - Income in Respect of a Decedent

Background - Income Taxation of Trusts and Estates

- Section 641(b) – “The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part.”

- Section 641-692 – income is tax to either the grantor, the trust/estate or the beneficiary

Background - Income Taxation of Trusts and Estates

- Income Taxed to Either Entity or Beneficiary
  - If income is accumulated and not deemed distributed, it is taxed to the trust or estate
  - If income distributed:
    - Trust gets deduction for amount of distribution, limited to DNI
    - Beneficiary accounts for income distributed on his own tax return, limited to DNI

2022 Tax Rates – Ordinary Income

If Taxable Income is:	The Tax is
Not over $2,750	10%
Over $2,750 but not over $9,850	$275 plus 24% of amount over $2,750
Over $9,850 but not over $13,450	$1,979 plus 35% of amount over $9,850
Over $13,450	$3,239 plus 37% of amount over $13,450

2022 Preferential Rates for Qualified Dividends and LTCG for Estates and Trusts

- TCJA retains the preferential rates for qualified dividends and long-term capital gains
- However, the thresholds for the 0%, 15% and 20% rates have been adjusted as shown on the next slide
- See Section 1(j)(5)

2022 Tax Rates – Capital Gains

If Taxable Income is:	Maximum Capital Gain Rate
Not over $2,800	0%
Over $2,800 but not over $13,700	15%
Over $13,700	20%

Trust Accounting Income – Who Gets What

- Allocation of receipts and disbursements between trust accounting income and principal
- Look at trust instrument
- If trust instrument is silent, look at state law
  - Uniform Principal and Income Act
    - Default statute
    - UPIA may differ from state to state

TAI v. DNI v. TI – They Ain't the Same

		TAI	DNI	TI
Dividends	$ 5,000	$ 5,000	$ 5,000	$ 5,000
LTCG	$10,000			$10,000
T/E Interest	$ 3,000	$ 3,000	$ 3,000	
Expenses	($ 4,000)	($ 2,000)	($ 4,000)	($ 4,000)
Total		$ 6,000	$ 4,000	$11,000

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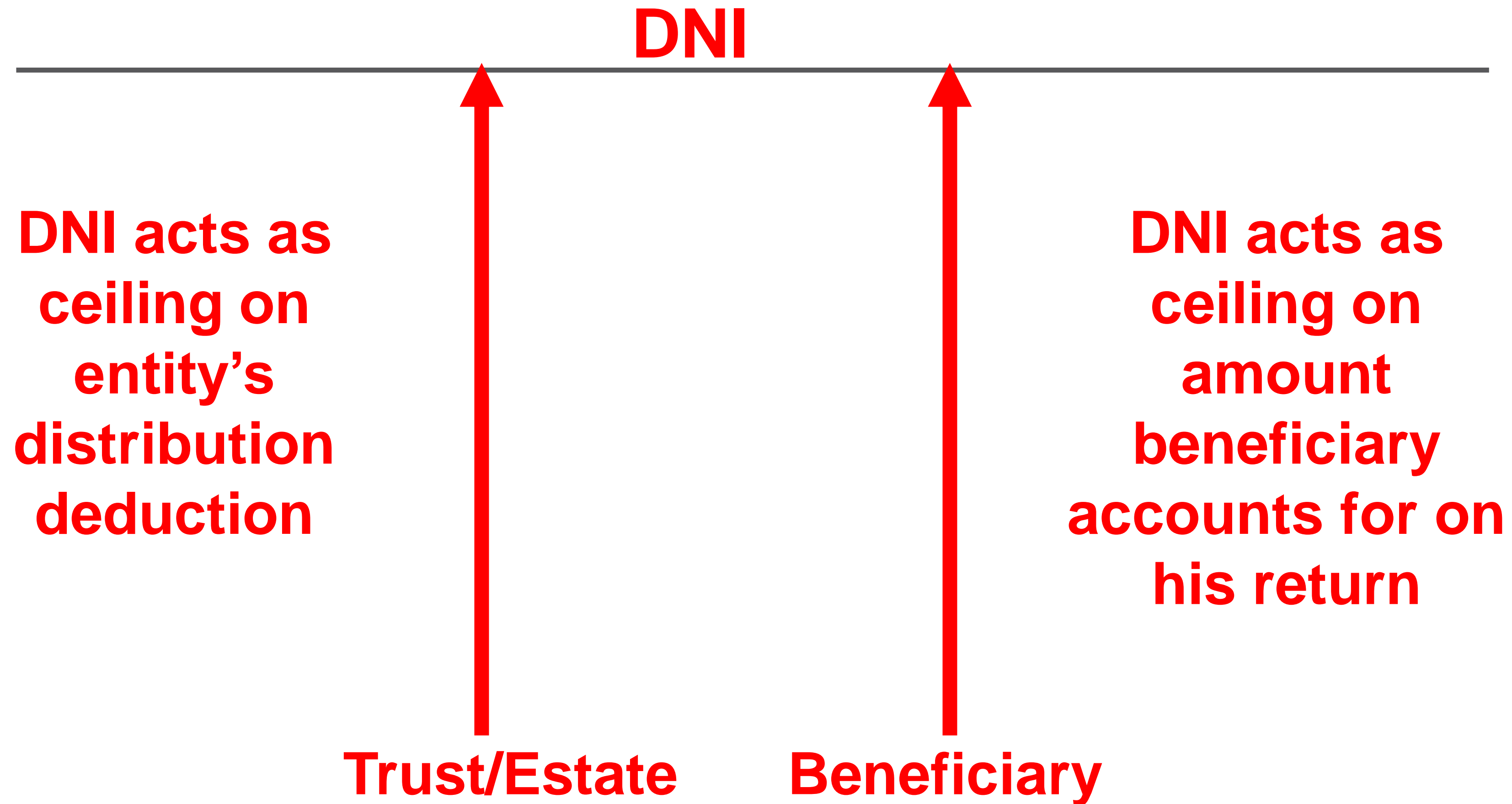
TAI v. DNI v. TI

- TAI – who gets what
- DNI – who pays the tax
- TI – what is subject to tax

Background - Income Taxation of Trusts and Estates - Distributable Net Income (DNI)

- Distributable Net Income (DNI) governs:
  - Amount of trust or estate's distribution deduction
  - Amount beneficiary accounts for on his own return
  - Character of income in beneficiary's hands

Background - Income Taxation of Trusts and Estates



Background - DNI - Sec. 643(a)

- Start With Taxable Income and . . .
  - *Add back* the distribution deduction
  - *Add back* the personal exemption
  - *Subtract out* capital gains/*add back* capital losses allocable to principal (except in the year of termination)
  - *Subtract out* extraordinary dividends and taxable stock dividends allocated to corpus for simple trust
  - *Add back* net tax-exempt income

DNI – Easy Example

Facts – Trust income:

- Interest $10,000
- Dividends $15,000
- Trustee's fees 5,000

DNI:		Line on 1041
Taxable income	$19,900	17 - Front
Add: Exemption	$100	-
DNI	$20,000	7 - Sch B

Taxable income:

Interest	$10,000
Dividends	$15,000
Less: Tr fees	($5,000)
Net	$20,000
Less: exemption	($100)
Taxable income	$19,900

DNI – Example with LTCG

Facts – Trust income:

- Interest $10,000
- Dividends $15,000
- LTCG $30,000
- Trustee's fees 5,000

Taxable income:

Interest	$10,000
Dividends	$15,000
LTCG	$30,000
Less: Tr fees	($5,000)
Net	$50,000
Less: exemption	($100)
Taxable income	$49,900

DNI:		Line on 1041
Taxable income	$49,900	17 - Front
Less: LTCG	($30,000)	6 – Sch B
Add: Exemption	$100	-
DNI	$20,000	7 – Sch B

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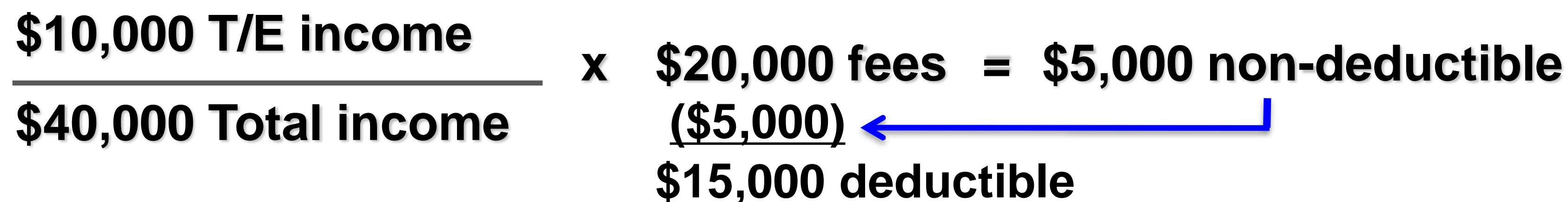
Non-Deductible Expenses - Sec. 265

- Sec. 265 disallows any deduction attributable to tax-exempt income
- Generally applies to deductions for production of income, usually trustee's fees and executor's fees
- If trust/estate has tax-exempt income, portion of trustee's and executor's fees are nondeductible
- No specific allocation formula
  - Fiduciary can use any reasonable method

Non-Deductible Expenses - Sec. 265 Example

Facts:

- Trust has $30,000 taxable interest and $10,000 T/E interest
- Incurs $20,000 trustee fee
- Portion of trustee fee attributable to T/E income is non-deductible



DNI – Example with LTCG and T/E Interest

Facts – Trust income:

- Interest $10,000
- Dividends $15,000
- LTCG $30,000
- T/E Interest $5,000
- Trustee's fees $5,000

Taxable income:

Interest	$10,000
Dividends	$15,000
LTCG	$30,000
Less: Tr fees	($4,167)
Net	$50,833
Less: exemption	($100)
Taxable income	$50,733

DNI:		Line on 1041
Taxable income	$50,733	17 - Front
Less: LTCG	($30,000)	6 - Sch B
Add: Net T/E interest	$4,167	2 - Sch B
Add: Exemption	$100	-
DNI	$25,000	7 - Sch B

Allocation of expenses to T/E interest:

T/E Interest	$5,000
$5,000 T/E Interest / $30,000 TAI x $5,000 =	(833)
Deductible trustee's fees	$4,167

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Distributions – Capital Gains

Including Capital Gains in DNI

- Generally, capital gains are allocated to principal and taxed to the estate or trust

- Compressed tax rate schedule for estates and trusts
  - Short-term capital gains taxed at 37% + 3.8% surtax if taxable income exceeds $13.450 (2022)
  - Long-term capital gains taxed at 20% + 3.8% surtax if taxable income exceeds $13,700 (2022)

- Planning point – have gains taxed to beneficiary where gains would most likely be taxed at a lower tax rate

- For capital gains to be taxed to a beneficiary, the capital gain must be included in DNI

DNI - Sec. 643(a)

- Note: capital gains generally not included in DNI but taxed to the trust or estate
  - Exceptions:
    - 3 situations under Reg. 1.643(a)-3
    - Paid to or set permanently set aside for charity. Reg. 1.643(c)
    - Year of termination

- Note: The rules regarding the allocation of DNI between the trust and its beneficiaries are applied differently to simple trusts versus complex trusts and estates

- Distributions of principal as well as trust accounting income (TAI) will “carry out” DNI
  - Exception: Specific bequests under Sec. 663(a)(1)

Including Capital Gains in DNI

- The regulations describe 3 circumstances under which capital gains can be included in DNI. Reg. 1.643(a)-3(b).

- Gains are included in DNI where they are, pursuant to the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by applicable local law:

1. Allocated to income (but if income under the state statute is defined as, or consists of, a unitrust amount, a discretionary power to allocate gains to income must also be exercised consistently and the amount so allocated may not be greater than the excess of the unitrust amount over the amount of DNI determined without regard to this subparagraph 1.643(a)-3(b));

2. Allocated to corpus but treated consistently by the fiduciary on the trust's books, records and tax returns as part of a distribution to a beneficiary; or

1. Allocated to corpus but actually distributed to the beneficiary or utilized by the fiduciary in determining the amount that is distributed or required to be distributed to a beneficiary.

Analyzing Regulation 1.643(a)-3(b)

- Reg. 1.643(a)-3(b) has specific requirements that must be met in order to have capital gains taxed to the beneficiary

- Regulations also has 14 examples – but they don't answer all our questions

- No pressing the "easy button"

- Regulations have:

  - Two prerequisites and

  - Three methods

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Analyzing Regulation 1.643(a)-3(b)

- Two prerequisites – capital gains included in DNI only if inclusion is pursuant to:
  - Trust agreement and local law; or
  - A reasonable and impartial exercise of discretion by the trustee in accordance with a power granted to the trustee by local law or the trust agreement if not prohibited by local law.

- Three methods
  - Allocated to **income**
  - Allocated to **corpus**, but treated consistently by the fiduciary on the trust's books, records and tax returns as part of distribution to the beneficiary
  - Allocated to corpus, but actually **distributed to the beneficiary or utilized by the fiduciary in determining the amount that is distributed** or required to be distributed to the beneficiary

Including Capital Gains in DNI

- Bottom line
  - Best when appropriate discretion is expressly granted in the trust agreement
    - Attorneys should consider including such discretionary language in trust instruments going forward
  - Alternatively, local law may provide the discretionary powers
  - If not, consider:
    - Power to adjust
    - Decanting (if available)

Types of Trusts

- Simple
- Complex
- Grantor – not important for our discussion today

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Simple Trust

- REQUIRED to distribute trust accounting income annually
- Makes no principal distributions, and
- Makes no distributions to charity

Complex Trust

- Makes discretionary distributions of trust accounting income
- Makes mandatory or discretionary distributions of principal, or
- Makes distributions to charity

Grantor Trust

- Grantor trust – grantor reports the income to extent of power over trust - §§673-677
- Beneficiary Deemed Owned Trust (BDOT) – beneficiary reports the income - §678

Distributions - Applicable Code Sections

Simple Trusts	Complex Trusts/ Estates
651	661
652	662

Distributions - Applicable Code Sections

	Simple Trusts	Complex Trusts/ Estates
Distribution Deduction	651	661
	652	662

Distributions - Applicable Code Sections

	Simple Trusts	Complex Trusts/ Estates
Distribution Deduction	651	661
Amt Bene Accounts For	652	662

Election of Estate's Fiscal Year End

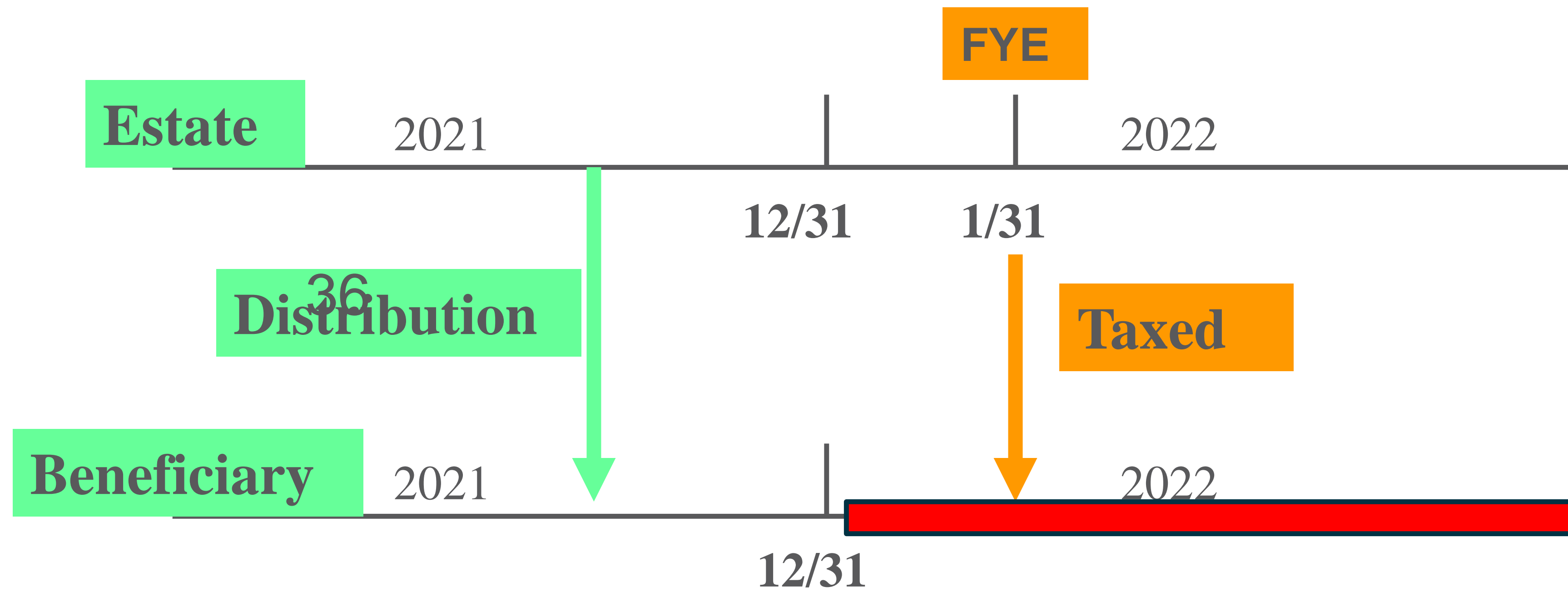
- Fiduciary may select estate's fiscal year end

- May be the last day of any month as long as first FYE doesn't exceed one year
  - Trust MUST use calendar year
    - Trust may get benefit of fiscal year by making a §645 election

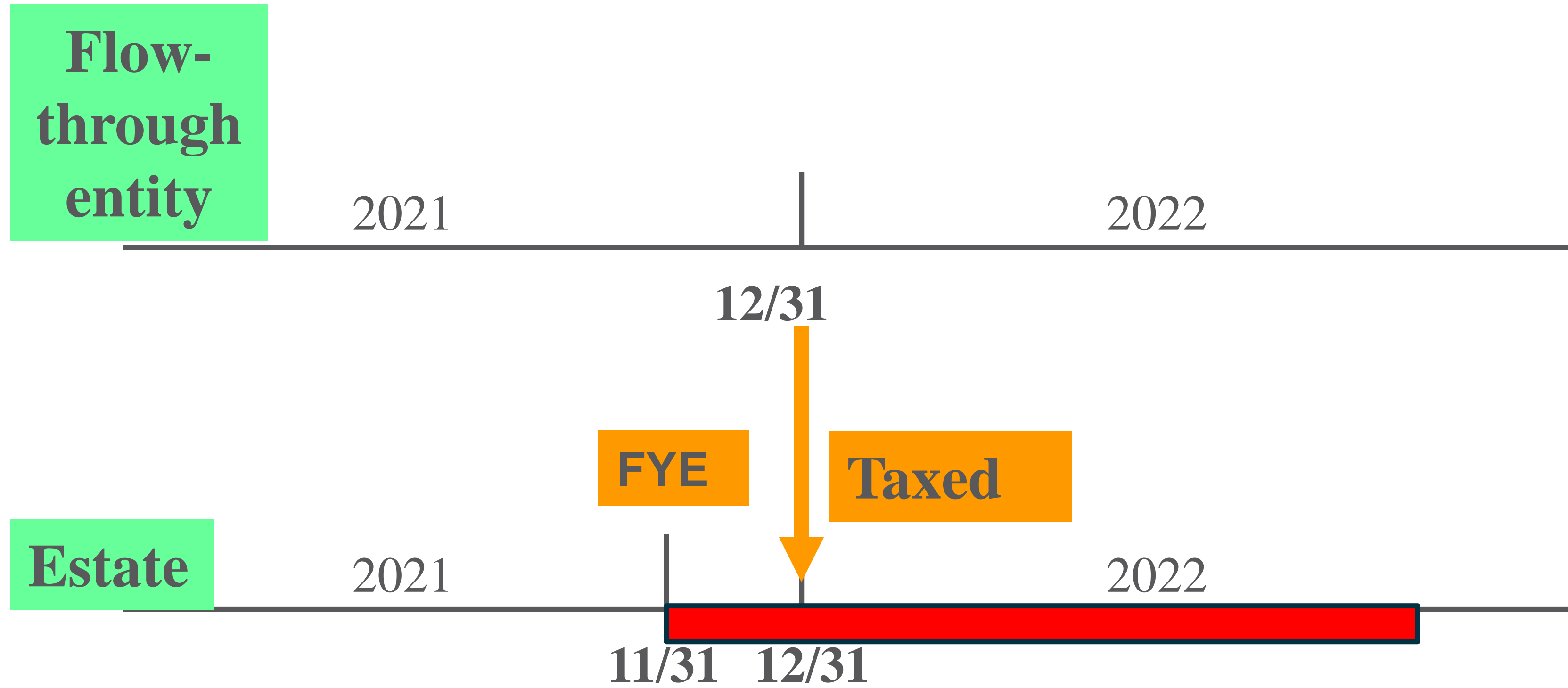
- Election made by filing income tax return with the selected year end

- May allow deferral of payment of tax
  - Cut off fiscal year before receipt of substantial income
  - Distributions from estate are deemed made to beneficiary on last day of estate's taxable year regardless of the actual date of distribution

Election of Estate's Fiscal Year End



Election of Estate's Fiscal Year End



Section 645 Election

- Treats “qualified revocable trust” as part of decedent’s estate for Federal fiduciary income tax purposes

- Election made jointly by estate’s personal representative and trustee

  – Election for limited period of time

  – See final regulations for making and terminating the election and tax treatment of trust and estate while election is in effect

  – Election made on Form 8855 by due date of fiduciary income tax return for the first taxable year of the estate, including extensions

Section 645 Election - Benefits

- File one return, combining estate and trust income
- Use fiscal year-end
- Qualify for estate fiduciary income tax charitable deduction
  - More liberal than trust fiduciary income tax charitable deduction
- $25,000 PAL deduction for rental R/E for 2 years of estate
- Eligible to hold S stock for duration of election
- Trust not obligated to make estimated tax payments for any taxable year ending within 2 years of the decedent's death

Section 642(c) Fiduciary Income Tax Charitable Deduction

Income Tax Charitable Deduction

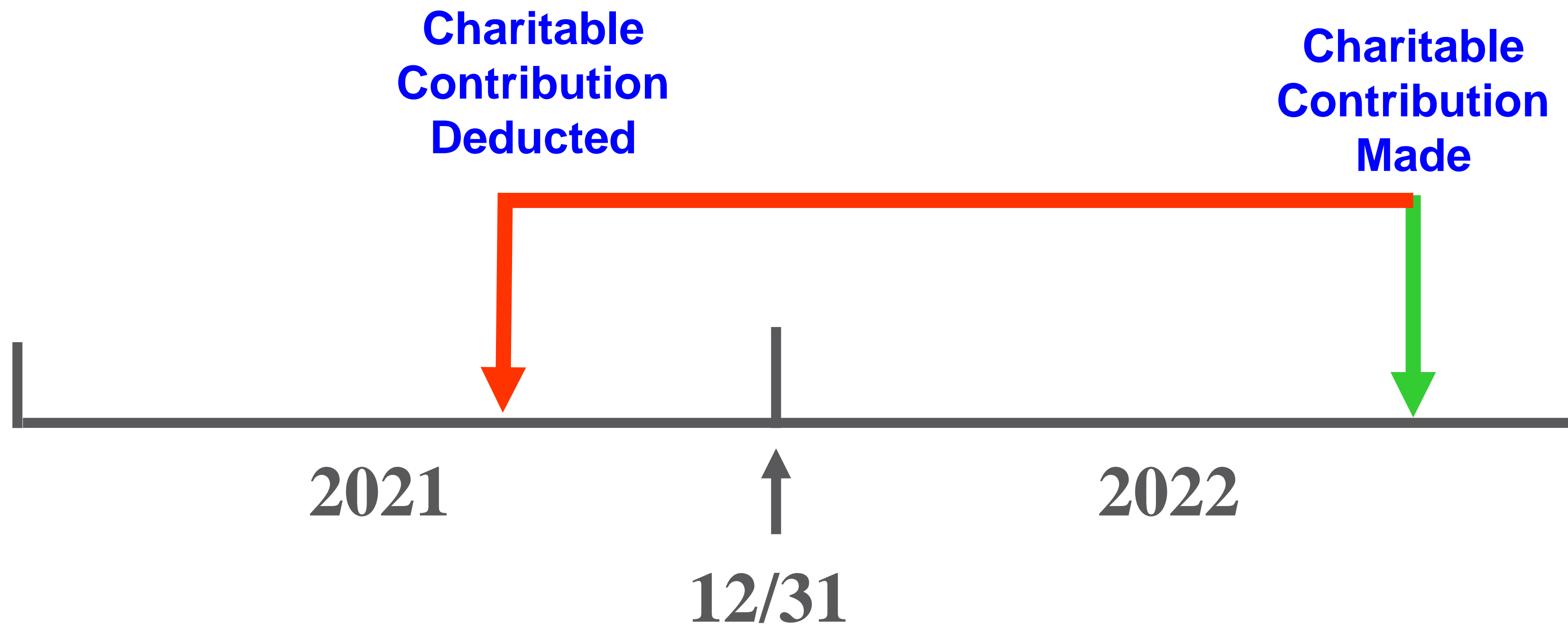
- Requirements:
  - Paid from gross (taxable) income
  - Paid pursuant to the governing document – consider giving trustee discretion to make distributions to charity
- Unlimited in amount
- No distribution deduction
- Distributions to foreign charities qualify
- May be paid for a "purpose" specified in §170(c) (determined without regard to §170(c)(2)(A))

Election to Treat Charitable Contribution as Made in Preceding Year

Income Tax Charitable Deduction

- Estate or trust can treat charitable contribution made in a succeeding taxable year as if made in the immediate preceding taxable year.
- Election made by filing a statement with tax return for which deduction is being claimed. See Reg. 1.642(c)-1(b)(3) for details of what statement must contain.
- May need amended return.
- Election can be made up until the due date, including extensions, of the succeeding year’s tax return.
- Can be made on an amended return if within above time frame after which the election is irrevocable unless consent from IRS obtained.
- Authority: Section 642(c)(1); Reg. 1.642(c)-1(b).

Election to Treat Charitable Contribution as Made in Preceding Year



Administration Expenses

Summary #1

- Deduct on either 706 or 1041
  - Waiver required if taken on 1041
  - Administration expenses can be split between 706 and 1041
- Compare estate tax rate with income tax rate
  - No 706 due, or 706 due but no tax, deduct on 1041
    - Exception: if applicable credit amount used, take administration expenses on 706
  - If estate tax due, deduct on 706
- Timing
  - If taken on 706, pay anytime
  - If taken on 1041, pay in year deduction desired
    - Caution: in year prior to termination, deductions in excess of income are wasted
    - If expenses exceed income, pay in year of termination and pay out “excess deductions” to beneficiaries – However, no excess deductions for years 2018-2025 under TCJA of 2017. But see final regulations under §67 which has 3 categories of excess deductions.

Administration Expenses

Summary #2

- Adjustment between income and principal
  - If expenses taken on 1041 when estate tax is payable, should income beneficiaries reimburse the remainder beneficiaries for the increase in the estate tax?

- Optimal marital deduction
  - Use of administration expenses on 706 reduces size of marital bequest
  - Use of administration expenses on 1041 decreases size of bypass trust and increases size of marital bequest

- No bypass trust
  - If administration expenses taken on 1041, estate tax generated via a circular calculation
  - If administration expenses taken on 706, no circular computation

Administration Expenses

Summary #3

- §67(g) (enacted as part of the TCJA of 2017) disallows expenses that constitute miscellaneous itemized deductions subject to the 2% floor for years 2018 to 2025.
  - However, expenses that are uncommon (or unusual or unlikely) for an individual to incur are deductible on the fiduciary income tax return (Form 1041). Knight v. Commissioner, 562 U.S. 181 (2008): §67(e); Reg. 1.67(e).
  - After 2025, such expenses will again become deductible but only to the extent they exceed 2% of the AGI of the estate or trust. While not a big deal for regular tax purposes, these expenses, post-2025, can have substantial AMT consequences.

- True double deductions
  - §691(b) deductions deductible on both 706 and 1041
  - Distinguish between §691(b) (incurred before death but payable after death) and §642(g) (post-death expenses)

Administration Expenses

Summary #4

- Consider the effect of administration expenses on the marital deduction (and amount of the exemption available for portability) and the charitable deduction on the estate tax return.

  – Estate transmission expenses – expenses that would not have been incurred but for the decedent's death and the consequent necessity of collecting the decedent's assets, paying the decedent's debts and death taxes and distributing the decedent's property to those who are entitled to receive it, e.g., executor's and attorney fees, probate fees, appraisal fees. They reduce the marital or charitable share.

  – Estate management expenses – expenses incurred in connection with the investment of estate assets or with their preservation or maintenance during a reasonable period of administration, e.g., investment advisory fees, stock brokerage commissions, custodial fees and interest. They do not reduce the marital or charitable share.

Distribution System – Simple Trusts

- Distribution deduction - trust is entitled to deduct all of its TAI (but not in excess of its DNI)
  - Items of income not included in gross income (e.g. tax-exempt income) are not deductible by the trust

- Inclusion by beneficiary – the TAI (but not in excess of its DNI) is includible in the beneficiary's gross income
  - Items of income not included in gross income (e.g. tax-exempt income) are not includible in the beneficiary's income

- Example: Simple trust has TAI and DNI for the year is $9,000. The TAI must be distributed to A. The trust gets a distribution deduction of $9,000 and the beneficiary must include $9,000 in his income.

Distribution System – Simple Trusts

- Multiple beneficiaries - If there is more than one beneficiary, the DNI is apportioned among them in proportion to the TAI received by each beneficiary.

- Example: Trust requires one-third of TAI be distributed to A and two-thirds of TAI be distributed to B. TAI and DNI for the year is $9,000. The trust gets a distribution deduction of $9,000.

  – A must report $3,000 (1/3 of $9,000) and B must report $6,000 (2/3 of $9,000).

Distribution System – Simple Trusts

- Character of income – items of income retain the same character in the hands of the beneficiary as they had in the hands of the trust

- Example: Trust requires one-third of TAI be distributed to A and two-thirds of TAI be distributed to B. TAI and DNI for the year is $9,000. The TAI and DNI consists of $6,000 of dividends and $3,000 of interest. The trust gets a distribution deduction of $9,000.

  – A must report $3,000 (1/3 of $9,000) and B must report $6,000 (2/3 of $9,000).

  – A's $3,000 distribution consists of $2,000 of dividends and $1,000 is interest.

  – B's $6,000 distribution consists of $4,000 of dividends and $2,000 of interest

Inclusion of Amounts in Gross Income of Beneficiaries of Complex Trusts - §662

The key to understanding the distribution rules for complex trusts and estates and the allocation of DNI among multiple beneficiaries consists of understanding six important concepts. They are:

(1) General Rule: DNI is allocated to the beneficiaries on a pro-rata basis i.e. amount of the distribution to the beneficiary/total distributions to all the beneficiaries x DNI = beneficiaries share of DNI

(2) the “tier system” of distributions,

(3) the separate share rule,

(4) the 65 day rule under §663(b)

(5) specific bequests under §663(a)(1)

(6) Distributions in Kind - §643€

Complex Trusts - Allocation of DNI

- Generally, DNI is allocated among beneficiaries proportionately, based on distributions to each beneficiary

- As with simple trusts, distributions from an estate or complex trust are generally considered to carry out a pro rata part of each item of DNI.

  – In other words, distributions from a complex trust or estate is deemed to consist of the same proportion of each class of items entering into the computation of DNI as the total of each class bears to the total DNI

Complex Trusts - Allocation of DNI

- Example – General Rule
  - Trust has $20,000 of DNI
  - Trustee distributes $30,000 to A and $10,000 to B
  - Under normal pro-rata rules, A would include $15,000 of DNI ($30,000 distribution/$40,000 total distribution x $20,000 DNI)
  - Under normal pro-rata rules, B would include $5,000 of DNI ($10,000 distribution/$40,000 total distribution x $20,000 DNI)

Complex Trusts – Special Rules in the Allocation of DNI

SIX IMPORTANT CONCEPTS:

- General rule: DNI allocated pro-rata based on distribution
- Tier System
- Separate Share Rule
- 65 Day Rule (§ 663(b) election)
- Specific Bequests - § 663(a)(1)
- Distributions in Kind - § 643(e)

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Complex Trust and Estates - Tier System

- The allocation of the distribution among various beneficiaries of a complex trust or estate is considerably more difficult than for the beneficiaries of simple trusts.

- How is DNI allocated when there are multiple beneficiaries, some of whom are entitled to net income and others are who are discretionary beneficiaries or receive distributions of corpus?

- This allocation is controlled by the "tier system". The "tier system" of taxation is contained in § 662(a)(2).

Complex Trust and Estates - Tier System

- If total distributions do not exceed DNI, the tiers are irrelevant.
- Amounts paid, credited or required to be distributed carry out DNI dollar for dollar, each reflecting its proportionate share of the items of income and deductions in DNI.
- Any remaining DNI not distributed is taxed to the trust.

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Complex Trust and Estates - Tier System

- If **distributions exceed DNI** and there are **multiple beneficiaries**, some who are **required to get trust accounting income (first tier beneficiaries)** and others who **receive distributions in the trustee's discretion (second tier beneficiaries)**, the tier of a distribution is important in determining the tax consequences to the beneficiary.

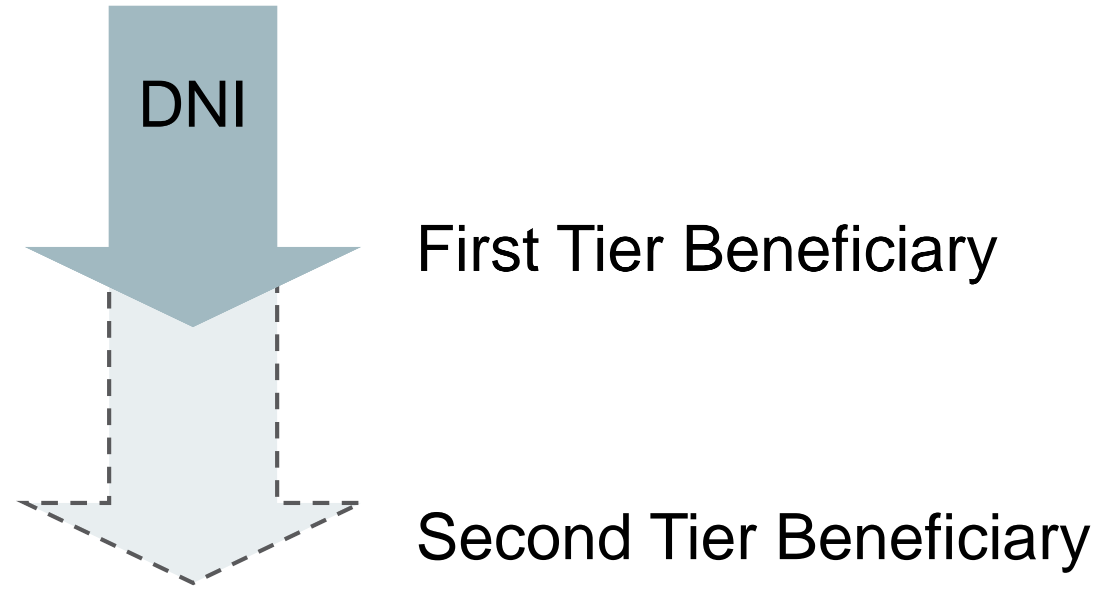
Complex Trust and Estates - Tier System

- The tier system of allocating DNI is applicable if:
  - (1) **Distributions exceed DNI;**
  - (2) There are **multiple beneficiaries;**
  - (3) Some beneficiaries are **required to get trust accounting income (first tier beneficiaries);**
  - (4) and others who **receive distributions in the trustee's discretion (second tier beneficiaries)**

Complex Trust and Estates - Tier System

- Two tiers:
  - First Tier - Distribution of trust accounting income *required* to be distributed currently
  - Second Tier - Distribution of *all other amounts* paid, credited or required to be distributed

Complex Trust and Estates - Tier System



DNI is taxed first to FTB and any balance of DNI is taxed to STB

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Complex Trusts – Tier System

Example: A trust instrument requires the trustee to distribute $30,000 of income to A and gives the trustee to discretion to distribute income and principal to B.

The trust has $40,000 of DNI.

The trustee distributes $30,000 to A and $20,000 to B.

If the normal pro rata rules were applied to the distributions, A would report $24,000 of DNI ($30,000/$50,000 x $40,000 DNI) and B would report $16,000 of DNI ($20,000/$50,000 x $40,000 DNI). The DNI would be allocated pro rata to each beneficiary based on distributions to each.

Complex Trusts – Tier System

Example (Cont.): Under the tier system, DNI would be allocated first to A (the first tier beneficiary) to the extent of the income required to be distributed to A ($30,000) and the balance of the DNI after taking into consideration the distribution to A ($40,000 DNI less $30,000 DNI allocated to A or $10,000) would be allocated to B (the second tier beneficiary).

Although B received a distribution of $20,000, there is only $10,000 of DNI remaining to be allocated to his distribution after allocating $30,000 of DNI to the first tier beneficiary's (A) distribution. The $10,000 balance of the $20,000 distributed to B is treated as a tax-free distribution of principal to B.

Complex Trust – General Rule v. Tier System

Beneficiary	General Rule	Tier System
A	$24,000	$30,000
B	$16,000	$10,000

Complex Trust and Estates
Tier System - Example

Facts: $40,000 DNI and TAI
Trust requires A receive 50% of income
Trustee makes discretionary distributions of $20,000 to each B and C

A is FTB (Gets 50% of $40,000 TAI)

B and C are STB (Discretionary Benes)

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Complex Trust and Estates
Tier System - Example

$40,000 DNI

($20,000) DNI for FTB

$20,000 DNI for STB

Divided by 2 STB

$10,000 DNI for Each STB

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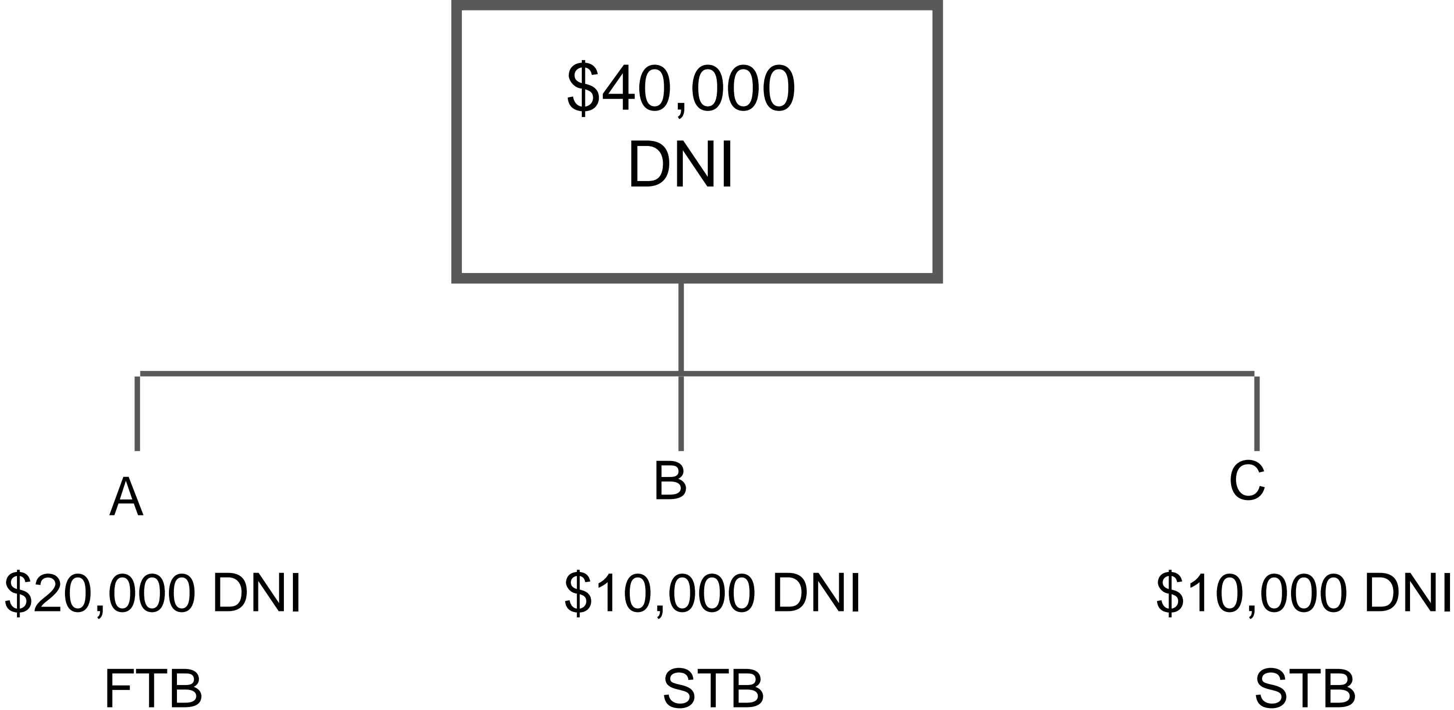
Complex Trust and Estates
Tier System - Example



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Complex Trusts – Tier System

- Effect of the charitable deduction.

- If an estate or trust is entitled to a **charitable deduction**, special rules apply for determining the amount taxable to first tier beneficiaries and the character of such amounts.

Complex Trusts – Tier System

- The second sentence of § 662(a)(1) and the last two sentences of § 662(b) provide that if the amount of income required to be distributed exceeds DNI computed without the charitable deduction, then the first tier beneficiaries take into income a higher, modified, DNI.

- The DNI for first tier beneficiaries is modified by not taking the charitable deduction into consideration in computing DNI.

- Such modified DNI sets the ceiling for taxing first tier beneficiaries.

- As a result, first tier beneficiaries never receive any advantage from the charitable deduction.

- The language of § 662(a) requires that the income required to be distributed be considered as distributed first to the individual beneficiaries and then to charities.

Complex Trusts – Tier System

- **Example**: Trust has DNI and trust accounting income of $50,000 and distributes the entire amount to A, who is required under the trust instrument to receive all income annually (i.e. A is a first tier beneficiary).

- Trust makes a $40,000 charitable contribution.

- Although under the general rule charitable contributions reduce DNI, so that in this case the available DNI appears to be only $10,000, under the second sentence of § 662(a)(1) the beneficiary is required to report the full $50,000 in his gross income.

- What appears to be $10,000 of DNI ($50,000 less $40,000 charitable deduction) is modified for purposes of first tier beneficiaries by adding the $40,000 amount paid to charity to the DNI allocable to first tier beneficiaries. Note the result: first tier beneficiaries do not get the benefit of any charitable deduction.

Complex Trusts – Tier System

- **Example**: Facts are the same as above except that the mandatory income distribution to A is only $20,000 and the trustee makes $25,000 of discretionary distributions to other beneficiaries (second tier beneficiaries).

- All of the first tier distribution to A is taxable – the DNI allocated to the first tier beneficiary is not reduced by the charitable deduction.

- The DNI available for the second tier beneficiaries is zero - $50,000 less ($20,000 first tier distribution + $40,000 charitable distribution).

- Thus, there is no DNI available for the second tier beneficiaries.

- The charitable deduction comes “off the top” for second tier beneficiaries but comes “off the bottom” for the first tier beneficiary. Thus, the charitable deduction reduces the amount available for second tier beneficiaries but not for first tier beneficiaries. The charitable deduction can be thought of as a tier 1 1/2.

Complex Trusts – Separate Share Rule

- What if one beneficiary has a portion or share of a trust in which no other beneficiary has right to receive a distribution from that share i.e., the beneficiary has a share that is separate from the interests of the other beneficiaries?
- This is where the separate share comes into play.
- The beneficiary is only taxed up to the DNI from his separate share.
- Thus, the DNI must be calculated separately for each share that constitutes a “separate share” and the beneficiary can only be taxed up to the amount of DNI earned in his separate share.
- The distribution deduction for each separate share are added together to determine the distribution deduction for the entire trust.

Complex Trusts – Separate Share Rule

- General rule: DNI is allocated proportionately to beneficiaries based on distributions made to each

- However, disproportionate distributions to beneficiaries from a trust or estate can lead to different tax treatment for different beneficiaries

- The separate share rule is designed to cure this inequity

- The separate share rule allocates DNI among the beneficiaries based on the DNI of their “share” of the trust.

- Distributions to beneficiaries who don’t have separate shares are allocated DNI based on distributions made to them over the total distributions made to all the beneficiaries in a particular year i.e. a proportionate share of DNI

Complex Trusts – Separate Share Rule

- The separate share rule is set forth in § 663(c).

- It states as follows: "For **the sole purpose of determining the amount of distributable net income** in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts."

Complex Trusts – Separate Share Rule

- Example – General Rule:
  - Trust has $20,000 of DNI
  - Trustee distributes $30,000 to A and $10,000 to B
  - Under normal pro-rata rules, A would include $15,000 of DNI ($30,000 distribution/$40,000 total distribution x $20,000 DNI)
  - Under normal pro-rata rules, B would include $5,000 of DNI ($10,000 distribution/$40,000 total distribution x $20,000 DNI)
  - Added fact: separate share rule applies. A's separate share earns $10,000 of DNI and B's separate share earns $10,000 of DNI

Complex Trusts – Separate Share Rule

A's Separate Share

DNI: $10,000

Distribution: $30,000

Amount included in A's income: $10,000, limited to his share of DNI

B's Separate Share

DNI: $10,000

Distribution: $10,000

Amount included in B's income: $10,000, limited to his share of DNI

Trust files one income tax return, takes a $20,000 distribution deduction, A includes $10,000 in income (even though he received $30,000 in distributions) and B includes $10,000 in income.

Complex Trusts - Separate Share Rule

- How do you determine if separate shares exist?
- Separate shares are determined by the language of the governing instrument.
- If the trust states that the corpus is to be divided into separate shares for each beneficiary, separate shares will be deemed to exist and each share must calculate it's share of DNI based on the income and expenses of each share.
- If the trust is a discretionary trust where the income and principal can be distributed to the beneficiaries in the trustee's discretion, separate shares do not exist and the DNI is allocated based on the distributions made to each beneficiary..

Complex Trusts - Separate Share Rule

- The separate share rule will not apply where a single trust is split into several separate trusts, as opposed to separate shares of the same trust. Reg. § 1.663(c)-1(a).

- Traditionally, the separate share rule applied only to trusts. Effective for decedents dying after August 5, 1997, the separate share rule now applies to estates as well.

Complex Trusts - Separate Share Rule

- Applies to estates (for decedents dying after August 5, 1997) and trusts

- DNI computed separately for each share

- Mandatory, not elective. Reg. 1.663(c)-1(d).

- Only affects share of DNI
  - Doesn't allow filing multiple returns
  - Doesn't allow separate calculation of tax
  - Doesn't allow multiple exemptions
  - Doesn't required separate accounts for each share. Reg. 1.663(c)-1(c).

- Want to avoid separate share rule?
  - Draft as a "spray" trust
  - Provide in trust document that the shares subdivide into separate trusts

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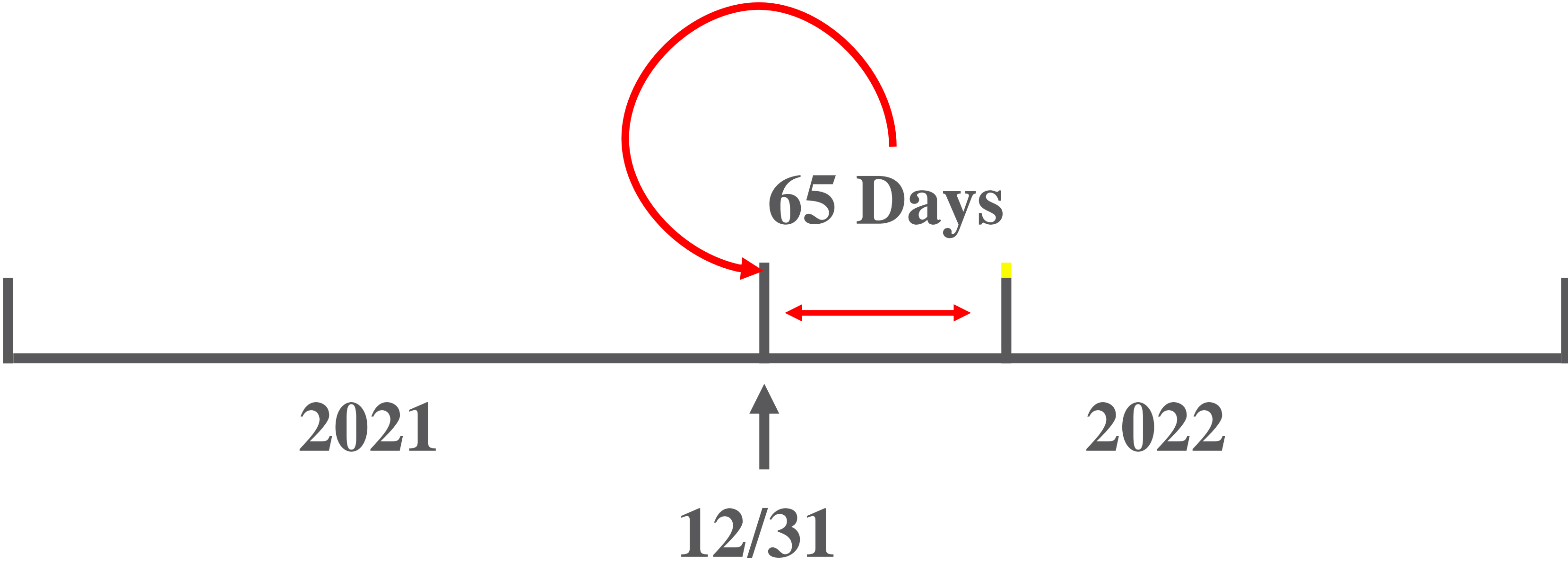
65 Day Rule aka Sec. 663(b) Election

- Applies to complex trusts and estates
- Allows a fiduciary to treat distribution made within 65 days of the year-end as being made on December 31 of preceding year
- Election must be made by due date of return
- Election is irrevocable – check box on Form 1041, Page 3, “Other Information,” Line 6
- Year by year election (e.g. good for 1 year only)
- Limited to > DNI less current year distributions or TAI not distributed
- A late election (or revocation) is possible under Reg. 1.9100-1 if the trustee can demonstrate that it acted reasonably and acted promptly to request an extension once it discovered the error.

65 Day Rule aka Sec. 663(b) Election



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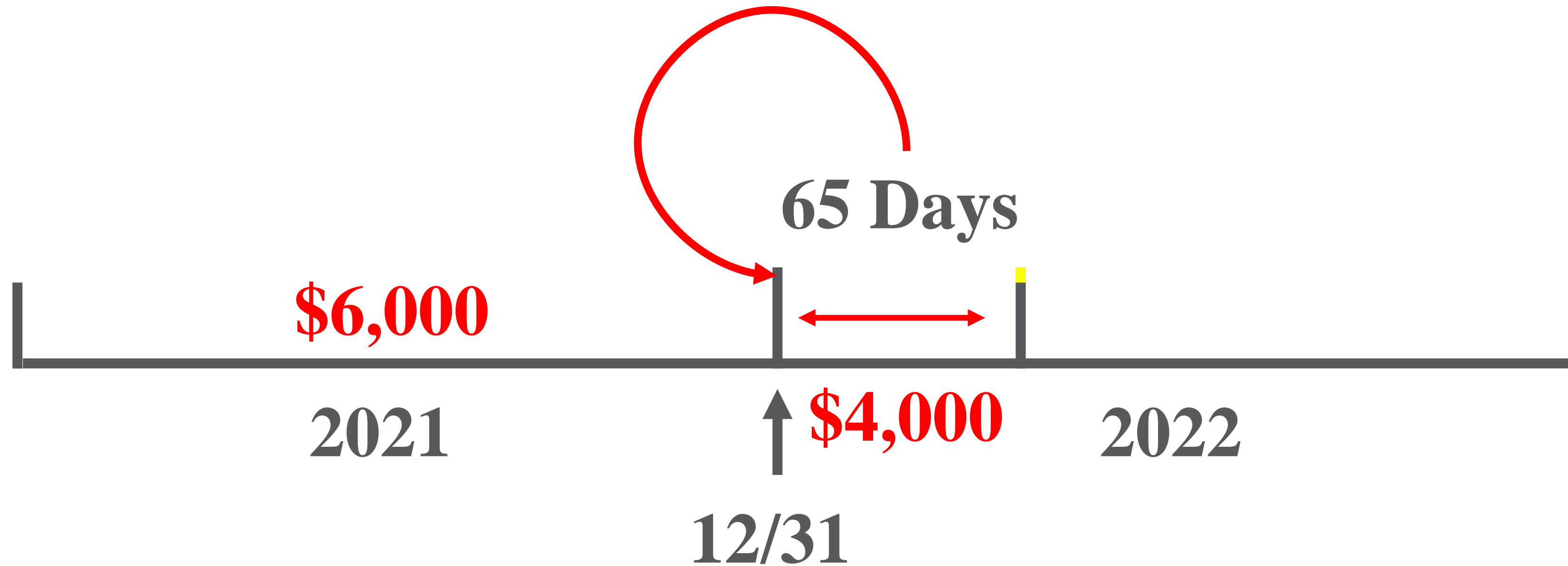
65 Day Rule aka Sec. 663(b) Election

Facts: $10,000 DNI for 2021

Distributes $6,000 in 2021, $4,000 in 2022



Specific Bequests - Sec. 663(a)(1)

- Bequest of specific sum of money or specific property do not carry out DNI

- Requirements:
  - Paid all at once, or
  - Paid in not more than 3 installments
  - Not paid from income

- Amount of bequest must be ascertainable at focal date e.g. date of death

- Not deductible by trust/estate or taxable to beneficiary

Specific Bequests - Sec. 663(a)(1)

- §663(a)(1) is an exception to the §661 and §662 rules governing distributions from estates and complex trusts.

- If a distribution meets the requirements of §663(a)(1), the estate or trust is not entitled to a distribution deduction under §661 and the beneficiary is not required to include the distribution in income under §662.

Section 643(e) Election – Distributions in Kind – Residuary Bequests

- Estate/Trust may elect, but is not required, to recognize G/L. §643(e)(3).

- Distribution carries out DNI, but amount of DNI depends on whether the Section 643(e) election was made
  - No Election: DNI carried out is lesser of basis or FMV of distributed property. §643(e)(2).
  - Election: DNI carried out is FMV of distributed property. §643(e)(3).

- Basis of property to beneficiary is basis of property to estate/trust plus or minus any gain or loss the estate/trust elects to recognize on the distribution. §643(e)(1).

- Holding period tacks if basis is same "in whole or in part" as transferor's basis, otherwise, holding period starts anew. §1223(2).

Section 643(e) Election – Distributions in Kind – Residuary Bequests

	No § 643(e)	§ 643(e)
Gain Recognized	No	Yes § 643(e)(3)(ii)
DNI Carried Out	<FMV or basis § 643(e)(2)	FMV § 643(e)(3)(iii)
Basis to Beneficiary	Basis +/- G or L § 643(e)(1) (carryover basis)	Basis +/- G or L § 643(e)(1) (FMV)
Beneficiary's Holding Period	HP Tacks § 1223(2)	HP Tacks § 1223(2)

Section 643(e) Election – Distributions in Kind

- **Example:** A trust has DNI of $50,000.
- The trustee funds a residuary bequest by transferring stock with a fair market value of $50,000 and a basis of $20,000.
- The trustee **does not make a §643(e) election**.
- The distribution of stock carries out $20,000 of DNI (the lower of the cost basis or fair market value of the stock). Since the trustee did not make a §643(e) election, the trust doesn't recognize any gain.
- The beneficiary takes a $20,000 basis in the distributed stock (the trust's $20,000 basis plus zero gain recognized by the trust).
- Since the beneficiary's basis is determined in whole or in part by reference to the trust's basis in the stock, the trust's holding period of the stock is tacked onto the beneficiary's holding period for purposes of determining if the gain is long-term or short-term.

Section 643(e) Election – Distributions in Kind

- **Example:** A trust has DNI of $50,000.
- The trustee funds a residuary bequest by transferring stock with a fair market value of $50,000 and a basis of $20,000.
- The trustee **makes a §643(e) election**.
- The distribution of stock carries out $50,000 of DNI (the fair market value of the stock). The §643(e) election causes the trust to recognize gain of $30,000 ($50,000 FMV less $20,000 basis).
- The beneficiary takes a $50,000 basis in the distributed stock (the trust's $20,000 basis plus the $30,000 of gain recognized by the trust).
- Since the beneficiary's basis is determined in whole or in part by reference to the trust's basis in the stock, the trust's holding period of the stock is tacked onto the beneficiary's holding period for purposes of determining if the gain is long-term or short-term.

Section 643(e) Election – Distributions in Kind

- Making the Election. A § 643(e) election is made by the estate or trust on its return for the taxable year for which the distribution was made. Check box on Form 1041, Page 3, “Other Information.” Line 7.

- The election is made by checking a box on the bottom of page 2 of the Form 1041.

- The election applies to all property distributions made during the year with the exception of § 663(a) property distributions. § 643(e)(3)(B), (e)(4). Thus, the estate or trust may not make a § 643(e) election in a particular year for some property distributions but not for others.

- Once made, the election may only be revoked with the consent of the Secretary of the Treasury. § 643(e)(3)(B), last sentence.

- The election is made on a year-by-year basis i.e. it can be made for property distributions in one year but not the next.

- The revocation of the § 643(e) election may be approved through a Reg. 301.9100 relief request. PLR 9641018.

“”Kenan” Gain

Reg. 1.661(a)-2(f)

- Funding a pecuniary bequest with appreciated property results in recognition of gain.
- Common with funding formulas
- Losses may be subject to Section 267 related party rules

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Terminating the Trust - §642(h)

NOLs, Capital Loss Carryovers, Excess Deductions, PALs

- NOL, capital loss c/o and “excess deductions” (subject to changes made by the TCJA pf 2017 and the 2020 final regulations) pass to the beneficiary on termination of an estate or trust

- Pass through only in the year of termination

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Terminating the Trust - §642(h)

Capital Loss Carryovers

- Unused capital loss c/o passes to beneficiary in year of termination of trust or estate
- No time limit on beneficiary to use capital loss c/o

Terminating the Trust - §642(h)

Excess Deductions

- "Excess deductions" occur where trust/estate expenses exceed income in year of termination
- Historically, "excess deductions" passed through to beneficiary on termination of trust/estate
  - Beneficiary could deduct on his personal return
- Deductible as miscellaneous itemized deduction subject to 2% floor
  - If beneficiary doesn't itemize, he can't use deduction
  - **Deduction disallowed under §67(g) from 2018 – 2025 but a special rule applies under the final §67(g) regs.**

Terminating the Trust - §642(h)

Excess Deductions – 2020 Final Regulations

- Excess deductions may consist of:
  - Deductions allowable in arriving at AGI under Section 62 and 67(e);
  - Itemized deductions under Section 63(d) allowable in computing taxable income; and
  - Miscellaneous itemized deductions currently disallowed under Section 67(g).
- Therefore, the final regulations segregate excess deductions into its components to determine the character, computation and deductibility.

Terminating the Trust - §642(h)

Excess Deductions – 2020 Final Regulations

- Deductions separated into three categories and its deductibility is determined by the category to which it is assigned:
  - Those allowable in arriving at AGI;
  - Those that are a non-miscellaneous itemized deductions; and
  - Those that are a miscellaneous itemized deduction.
- Each deduction retains its separate character in the hands of the beneficiary that it had in the hands of the trust or estate, i.e., as an amount in arriving at AGI, as a non-miscellaneous itemized deduction or as a miscellaneous itemized deduction.

Terminating the Trust - §642(h)

Passive Activity Loss Rules

- If the estate or trust has an interest in a passive activity that is being distributed to a beneficiary (other than in satisfaction of a pecuniary bequest), any suspended PALs associated with the activity at the time of distribution increases the basis of the interest distributed to the beneficiary. Section 469(j)(6).

State Income Tax Considerations

Background

- What state can tax the income of a trust?
  - Can be taxed in none, one or more than one state
  - Due process limitations
- What factors affect state taxation of trusts?
  - What constitutes sufficient nexus with a state to justify imposing a state fiduciary income tax?
  - States have different “contact” requirements
- Can you control which state will tax the trust?
- Can you avoid state taxation entirely?
- Income at issue: accumulated income and capital gains

State Income Tax Considerations

Background

- No symmetry in basis for taxation jurisdiction
- Must review each individual state statute
  - Resident versus non-resident trust
  - Based on contacts required for taxing jurisdiction
  - Are those contacts constitutional?
- Establish trust in state with no tax or move trust to state with no tax
- Monitor change of residency of grantor, beneficiary, trustee or place of administration

State Income Tax Considerations

Background

- Resident trust – the state can tax all of the trust's income
- Non-resident trust – a state can tax only the income apportioned to the state i.e., state sourced income

State Income Tax Considerations

Background – How Do States Determine if a Trust is a "Resident" Trust?

- Residence of the grantor –NY, NJ, MI, IL
  - Testamentary trust – residence at time of death
  - Inter vivos trust – residence when trust is created or funded or when a revocable trust becomes irrevocable
- Residence of the beneficiaries –NC, CA, GA, TN, ND
- Residence of the trustees - AZ, CA, NC
  - Or where corporate trustees are organized or maintain their principal place of business
- Location of the administration of the trust –WI, CO, KS, IN, SC, UT
- "Source" income – Income derived from sources within the state (e.g. R/E rentals, business income, sales of real estate located in the state) may be taxed regardless of whether the taxpayer is a resident or non-resident

Conclusion

- Basics of income taxation of estates and trusts
- Compressed income tax rates
- Trust accounting income (TAI)
- Distributable net income (DNI)
- Including capital gains in DNI
- Types of trusts
  - Simple
  - Complex
  - Grantor
- Fiscal year end
- Section 645 election
- Section 642(c) – fiduciary income tax charitable deduction

Conclusion

- Administration expenses
- Distribution system
  - General rule
  - Tier system
  - Separate share rule
  - Sixty-five day rule
  - Specific bequests
  - Section 643(e) election
- Year of termination – NOLs, capital loss carryover, excess deductions, PALs
- State income taxation of trusts

Conclusion – Bottom Line

- Covered a lot of material
- It took me years to understand this material
- It is necessary for estate planners to understand Subchapter J
- But, it is not easy

Resources

- Income Taxation of Estates and Trusts, Soled, Aker, Doyle, Siegel and Weisblatt, Carolina Academic Press (December, 2019)
- Blattmachr on Income Taxation of Estates and Trusts, 17th Ed., 2018 (Practising Law Institute)
- Federal Income Taxation of Estates, Trusts and Beneficiaries, 3rd Edition by Ferguson, Freeland and Ascher (Aspen/CCH)
- 1041 Deskbook (Practitioners Publishing Co.)
- Income Taxation of Trusts and Estates, 852-3rd (BNA portfolio – Estate, Gift and Trust series)
- Federal Income Taxation of Decedents, Estates and Trusts, David A. Berek (2020 Edition) (Wolters Kluwer)
- Federal Income Taxation of Trusts and Estates, by Zaritsky and Lane, 3rd Edition (RIA/Thompson/West)
- Income Taxation of Fiduciaries and Beneficiaries by Byrle M. Abbin, 2 volumes, 2019 Edition (Wolters Kluwer)

Thank You!

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Delaware Tax Institute Panel Discussion on Income Taxation of Trusts and Estates

December 2, 2022

Moderator: Jocelyn M. Borowsky, Esq., Partner at Duane Morris LLP

Panelist: Jeremiah W. Doyle IV, Senior Vice President and Senior Wealth Strategist at BNY Mellon Wealth Management

Panelist: Kevin M. Barry, CFP, Principal and Director of Fiduciary Tax Consulting at Bessemer Trust

Questions:

1. An irrevocable non-grantor trust gives the primary beneficiary a 5 and 5 power. The beneficiary does not exercise the power in 2022. Is all of the trust's net income taxable to the trust?

2. A non-grantor trust holds marketable securities which have appreciated in value. The trustee is considering making a discretionary distribution to the beneficiary of appreciated stock in kind. Will the distribution of the appreciated property trigger any capital gain to the trust or to the beneficiary? If the trust has incurred losses in the same tax year that the trustee distributes the gain property, can the appreciated property offset the loss? Would the answer change if the trustee was required to pay the beneficiary the lesser of $50,000 or 1% of the value of the trust property, and the trustee paid it with appreciated property in kind?

3. Suppose the trust is a GRAT and the trustee pays the annuity with appreciated stock? Isn't that a pecuniary payment?

4. A $20 million estate has a pecuniary bequest in the amount of $12 million and the residuary estate is to pass to a marital trust. In 2022, the executor makes a partial distribution of $6 million to the recipient of the pecuniary bequest and funds the marital trust with $6 million. The estate has $600,000 of net income in 2022. How is the income shared among the estate and the beneficiaries in 2022?

5. A $20 million estate has a pecuniary bequest in the amount of $12 million and the residuary estate is to pass to a marital trust. The estate's income in 2022 is $600,000. The estate's marketable securities are down $2 million since the decedent's date of death. Should the executor sell the securities to incur the loss in 2022? Can the estate pass out the loss to the recipients of the pecuniary bequest? Can the estate pass out the loss to the marital trust? What about in the year of termination? Is there any way to take the loss?

6. A residuary trust is funded with an inherited IRA account. The IRA RMDs are to be paid to the trust. The trust is not a conduit trust (it's an accumulation trust). The trustee has discretion to pay out income and principal to the beneficiary. Should the trustee distribute the RMD to the beneficiary each year so as to carry out the trust income? Are RMDs considered income or principal under the Principal and Income Act?

7. The grantor settled a SLAT for her husband which holds stock in an S corporation. The grantor died and now a decision must be made to qualify the SLAT to hold the S corporation stock. Should an ESBT election be made or a QSST election be made? And when should it be made?

8. A non-grantor trust authorizes the trustee to distribute income and principal in its discretion to or for a class of beneficiaries consisting of Son and Son's descendants. Son is in a low income tax bracket. The trustee has always treated capital gains proceeds as being allocable to trust principal. The trustee is contemplating the sale of low basic publicly traded stock held in trust. It will generate a lot of taxable gain. Can the trustee carry out the tax gain to Son by making a distribution of the proceeds of sale? Would the answer change if the trustee makes the distribution within the first 65 days of the tax year following the year of sale? Would the answer change if the publicly traded stock was held in a single member wholly owned LLC which sells the stock and distributes the proceeds to the trust, and then the trustee distributes the cash to Son?

An Overview of the Delaware Disciplinary Process and Some Ethical Considerations for Tax Professionals
Delaware Tax Institute, 12/2/22

I. Nature of the Legal Profession

II. Regulation and Self-Government

III. Delaware Office of Disciplinary Counsel
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IV. Sources of Ethical Obligations
a. For lawyers
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V. Ethical issues
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VI. Best practices
a. Selecting your client wisely
b. Clearly define the scope of engagement
c. Managing your client and client expectations
d. Keep the client advised