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INCOME AND ESTATE TAX UPDATE TAX -2025

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TAX NEWS ____ *4*
Appointment of New IRS Commissioner ____ **4**
BOI Update ____ **4**
Latest Updates on BOI Reporting ____ 4
Trump Tax Agenda ____ **5**
Individual tax provisions to sunset after 2025 ____ 6
Individual tax rates ____ 6
Standard deduction ____ 6
Itemized deductions: ____ 6
SALT ____ 6
Mortgage interest deduction: ____ 6
Miscellaneous itemized deductions: ____ 6
Child tax credit: ____ 7
Personal exemptions ____ 7
Alternative minimum tax (AMT) exemption and phaseout: ____ 7
Business tax provisions to Sunset after 2025 ____ 7
Corporate tax rate: ____ 7
Qualified business income (QBI) 20% deduction (Sec. 199A): ____ 7
Bonus depreciation on qualified property ____ 7
Estate and gift taxation ____ 7
Income Tax Developments ____ *9*
Changes for 2025 ____ **9**
2025 Federal Income Tax Brackets and Rates ____ 9
2025 Federal Income Tax Brackets and Rates ____ 9
Standard Deduction and Personal Exemption ____ 10
Alternative Minimum Tax ____ 10
Earned Income Tax Credit ____ 11
Child Tax Credit ____ 11
Capital Gains Tax Rates and Brackets (Long-Term Capital Gains) ____ 11
Qualified Business Income Deduction (Sec. 199A) ____ 11
Unchanged for tax year 2025 ____ 11
Personal exemptions for tax year 2025 remain at 0, as in tax year 2024. ____ 12
Itemized deductions. ____ 12
Lifetime learning credits. ____ 12
Certain procedural matters pertaining to individual taxpayers are updated annually. ____ 12
Rev. Procs. 2024-1, 2024-2, and 2024-3. ____ 12
Rev. Proc 2024-2, with revised IRS procedures for furnishing technical advice, was not changed significantly from Rev. Proc. 2023-2. ____ 12
Sec. 25C: Energy-efficient home improvement credit ____ 13
TAX CASES AND RULINGS ____ **13**
Secure 2.0 Guidance: ____ 13
Section II.E of the notice discusses Section 117 of SECURE 2.0. ____ 13

Notice Section II. 13
Before SECURE 2.0, an employer offering a SIMPLE plan was not allowed to adopt a qualified retirement plan. 14
Notice Section II.L discusses Section 604 of SECURE 2.0, which changed the requirement that employer matches or contributions be allocated to the deferral portion of a 401(k) plan with a Roth feature. 14
Sec. 401: Qualified pension, profit-sharing, and stock bonus plans 14
Disaster relief distributions from retirement accounts: 15
Notice 2024-35 15
Sec. 32: Qualifying child is necessary for EITC: 15
Sec. 36B: Refundable credit for coverage under a qualified health plan 15
Sec. 61: Gross income defined. 16
Sec. 72(t) penalty: 19
Failure to Report 19
Sec. 165: Losses 19
Theft loss I — fraudulent mortgage scheme: 20
Theft loss II— reduction in cash value of life insurance: 21
Sec. 170(h): Qualified conservation contribution 21
Sec. 130: Certain personal injury liability assignments 23
Sec. 274: Disallowance of certain entertainment, etc., expenses 23
Qualified vs. nonqualified plan: 24
Sec. 404: Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan 25
Sec. 408: Individual retirement accounts 25
Trust named as beneficiary: 25
Criminal forfeiture of an IRA: 26
Sec. 469: Passive activity losses and credits limited; Sec. 1411: Imposition of tax 26
Sec. 4973: Tax on excess contributions to certain tax-favored accounts and annuities 27
Sec. 6015: Relief from joint and several liability on joint return 28
Sec. 6654: Failure by individual to pay estimated income tax 29

Estate Tax Developments ***31***

Changes Exemption Amounts - Inflation adjustments **31**

Annual Git Tax Exclusion 31
Gifts to Non-Citizen Spouses 31
Estate and Gift Tax Exemption 31

Potential sunset of higher estate/gift and GST exemptions **32**

CASES AND RULINGS **32**

Key items in the IRS Priority Guidance Plan 32
New final GST exemption regulations 33
Proposed foreign trust regulations 33
Increase in estate and gift filings and IRS examinations 33
IRS guidance on related-party basis shifting and irrevocable grantor trusts 34
Landmark transferee liability decision: Estate of Paulson 35
Life insurance valuation issues: DeMatteo 36
Life insurance and redemption agreements: Connelly 37

Buy-sell agreement special valuation rules: Huffman 38
Chief Counsel Advice (CCA) 202352018 38
Termination of QTIP trust did not trigger deemed gift: Estate of Anenberg 39
Charitable planning: Hoensheid 40
Bona fide debt vs. gift: Estate of Bolles 40

Pennsylvania Directed Trust Act 41

Trust Directors 41
Trust Protectors 42
Trust Directors for Investments 43
Duties and Liabilities of Trust Directors 43
Should My Trust Have a Trust Director? 44

TAX NEWS

Appointment of New IRS Commissioner

IRS Commissioner Danny Werfel stepped down on January 20 before his five-year term expired after Trump signaled a desire to shake up agency leadership.

Trump made it official on Monday, nominating former Missouri Republican Rep. Billy Long as IRS commissioner. Long's background as a certified auctioneer with limited tax experience and no college degree distinguishes him from typical IRS commissioner nominees. The former auctioneer and radio host was a member of the House Energy and Commerce Committee, not the tax-writing Ways and Means Committee, and once supported a bill that would have defunded the IRS.

Former Commissioner Werfel holds a Master's Degree in Public Policy from Duke University, a Juris Doctor from the University of North Carolina at Chapel Hill and a Bachelor's Degree in Industrial and Labor Relations from Cornell University.

This appointment probably signals that the IRS's crusade against wealthy tax cheats will likely lose steam this year if Republicans slash IRS funding as promised. Until a new commissioner is confirmed, longtime IRS employee and Deputy Commissioner Douglas O'Donnell will serve in an acting capacity.

BOI Update

Latest Updates on BOI Reporting

In yet another twist from the ongoing litigation of the Corporate Transparency Act (CTA), as of Dec., 26, 2024, businesses that meet the definition of a "reporting company" do not have Beneficial Ownership Information (BOI) reporting requirements under the CTA.

The U.S. Court of Appeals for the Fifth Circuit's merits panel is currently expediting an appeal of a decision just days earlier by the motions panel of the court that temporarily granted BOI reporting requirements be allowed, pending appeal.

Based on the Dec. 26 decision, all deadlines — the original ones and the extended ones the U.S. Treasury put in place after the government's appeal was granted — are no longer in effect because BOI reporting requirements are temporarily halted.

Businesses that wish are able to voluntarily file a BOI report.

The following is a summary of decisions over the past three weeks during this ongoing litigation.

Dec. 23: The Fifth Circuit grants an Emergency Motion for Stay pending appeal that reinstates BOI reporting requirements. With about 32 million businesses expected to be impacted, the Treasury Department announces an extension of deadlines for reporting to the Financial Crimes Enforcement Network (FinCEN). Again, these deadlines currently are not in effect.

- Reporting companies created or registered prior to Jan. 1, 2024, have until Jan. 13, 2025.
- Reporting companies created or registered in the U.S. on or after Sept. 4, 2024, that had the deadline between Dec. 3 and Dec. 23, 2024, have until Jan. 13, 2025.
- Reporting companies created or registered in the U.S. on or after Dec. 3, 2024 and on or before Dec. 23, 2024, have an additional 21 days from their original filing deadline to file.
- Reporting companies created or registered in the U.S. on or after Jan. 1, 2025, have 30 days to file after receiving actual or public notice that their creation or registration is effective.
- At the present time, none of this action from the Fifth Circuit impacts the members of the National Small Business Association (if a member as of March 1, 2024) nor the original plaintiffs in National Small Business United v. Yellen, who do not have to report their BOI at this time.
- Dec. 17: The Fifth Circuit denies a motion brought by the U.S. Department of Justice to stay the preliminary injunction.
- Dec. 3: A federal district court in Texas issues an injunction that temporarily blocks enforcement of the CTA and its reporting rule.

The final outcome of this case remains uncertain, so individuals that could be subject to BOI reporting based on future court decisions should stay up to date on legal proceedings that could impact compliance requirements, especially if some of the previously proposed deadlines are reinstated.

Trump Tax Agenda

The law known as the Tax Cuts and Jobs Act (TCJA) of 2017, P.L. 115-97, included some major changes to the Code. A number of significant provisions are set to expire after 2025. It is an important part of the Trump tax agenda to extend some or all those changes beyond the end of this year. And Republicans have signaled they plan to repeal or roll back some of the energy tax credits in the Democrats' Unlike most legislation in the narrowly divided

federal legislature, simple majorities will be able to move that bill thanks to a process known as budget reconciliation.

"The Byrd Rule," named for the late Sen. Robert Byrd (D-W.Va.), dictates reconciliation legislation can't include policies which increase the deficit outside the 10-year budget window absent offsets, or touch Social Security. Provisions found to be in violation of those restrictions during deliberations with the Senate's parliamentarian are often simply dropped from the bill rather than finding the 60 votes necessary to include them.

Although Congress may act to extend some or all of them, it is important to know which provisions are expiring so taxpayers can be prepared to maximize their tax savings in case the provisions sunset as currently scheduled.

Individual tax provisions to sunset after 2025

Individual tax rates: The TCJA lowered tax rates to 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate decreased to 37% from 39.6%. These tax rates are set to sunset Dec. 31, 2025. The top tax rate beginning Jan. 1, 2026, reverts to 39.6%.

Standard deduction: The standard deduction was nearly doubled for all filing statuses ($12,000 for single filers and $24,000 for married filing jointly) by the TCJA. As a result, many taxpayers have not itemized deductions. Starting in 2026, the standard deduction will be about half of what it is currently, adjusted for inflation.

Itemized deductions: The following items were temporarily modified or suspended by the TCJA:

SALT: The state and local tax (SALT) deduction was capped at $10,000, which had a significant impact on taxpayers in high-tax states. After 2025, this limitation will expire, allowing greater benefit from deducting taxes paid during the calendar year, including real estate taxes, state or local income taxes, and personal property taxes.

Mortgage interest deduction: The TCJA generally suspended the home equity loan interest deduction. It limited the home mortgage interest deduction to the first $750,000 of debt (if married filing jointly) for any loan originating on or after Dec. 16, 2017. Beginning in 2026, the mortgage interest deduction will revert to pre-TCJA levels, allowing interest to be deducted on the first $1 million in home mortgage debt and $100,000 in a home equity loan.

Miscellaneous itemized deductions: The TCJA temporarily eliminated most miscellaneous itemized deductions, such as investment/ advisory fees, legal fees, and unreimbursed employee expenses. These deductions will once again be allowed, starting Jan. 1, 2026, under the previous rules, to the extent they exceed 2% of the taxpayer's adjusted gross income.

Other individual tax items:

The TCJA's sunset also implicates several credits and other pertinent amounts and thresholds, including the following:

Child tax credit: The child tax credit was increased from $1,000 to $2,000 per qualifying child. This higher tax credit will revert to pre-TCJA levels in 2026 of $1,000 per qualifying child.

Personal exemptions: The TCJA temporarily suspended personal exemptions. The personal-exemption rules will return in 2026 once the provision sunsets. The personal exemption will be $2,000 per taxpayer and qualified dependents, adjusted for inflation (for 2023, the deemed amount, used in calculating other tax amounts that reference it, is $4,700). The personal exemption phases out at higher income levels.

Alternative minimum tax (AMT) exemption and phaseout: The TCJA increased exemption amounts as well as the exemption phaseout threshold, lessening the AMT burden on taxpayers. At sunset, the AMT exemption will revert to pre-TCJA levels.

Business tax provisions to sunset after 2025

Corporate tax rate: The TCJA permanently changed the corporate tax rate structure, which previously had a top rate of 35%, to a flat 21% tax rate regardless of the amount of corporate taxable income. This provision is one of the few that will not expire at the end of 2025.

Qualified business income (QBI) 20% deduction (Sec. 199A): Owners of passthrough businesses, such as partnerships and S corporations, as well as sole proprietorships, may currently claim a deduction of up to 20% of QBI. Beginning in 2026, the Sec. 199A QBI deduction no longer will be available.

Bonus depreciation on qualified property: Sec. 168(k) allows an additional first-year depreciation deduction equal to an applicable percentage of the cost basis of qualified property placed in service during the year. The TCJA changed the applicable percentages and qualifying property. Used property currently qualifies for bonus depreciation, except for property purchased from related parties.

Estate and gift taxation

The TCJA effectively doubled the estate and gift tax basic exclusion amount from $5,490,000 in 2017 to $11,180,000, adjusted each subsequent year for inflation, beginning with decedents dying and gifts made in 2018. The 2023 exclusion amount is $12.92 million per person ($25.84 million for married couples).

Taxpayers who die through 2025 with a taxable estate greater than the exclusion amount can be subject to a federal tax rate of up to 40%. Remember, some states have estate tax as well, so estates can end up with less than 60% of the net estate assets after paying the estate tax.

At the end of 2025, this tax provision will sunset, cutting the exclusion roughly in half. Individual taxpayers with significant estates that are above the amount that the exclusion will revert to should consult with their tax advisers and estate attorneys as soon as possible to take advantage of the TCJA's temporary increase in the exclusion by making gifts before the end of 2025. It is important that clients start planning now to be well prepared for when the estate tax and gifting exclusion decreases.

Income Tax Developments

Changes for 2025

On a yearly basis, the Internal Revenue Service (IRS) adjusts more than 60 tax provisions for inflation to prevent what is called "bracket creep." Bracket creep occurs when inflation pushes taxpayers into higher income tax brackets or reduces the value of credits, deductions, and exemptions. Bracket creep results in an increase in income taxes without an increase in real income. Many tax provisions—both at the federal and state level—are adjusted for inflation. Bracket creep occurs when inflation, rather than real increases in income, pushes people into higher income tax brackets or reduces the value they receive from credits and deductions.

The IRS previously used the Consumer Price Index (CPI) as a measure of inflation prior to 2018. However, with the Tax Cuts and Jobs Act of 2017 (TCJA), the IRS now uses the Chained Consumer Price Index (C-CPI) to adjust income thresholds, deduction amounts, and credit values accordingly.

The new inflation adjustments are for tax year 2025, for which taxpayers will file tax returns in early 2026. On average, tax parameters that are adjusted for inflation will increase by about 2.8 percent.

2025 Federal Income Tax Brackets and Rates

In 2025, the income limits for all tax brackets and all filers will be adjusted for inflation and will be as follows (Table 1). The federal income tax has seven tax rates in 2025: 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent. The top marginal income tax rate of 37 percent will hit taxpayers with taxable income above $626,350 for single filers and above $751,600 for married couples filing jointly.

2025 Federal Income Tax Brackets and Rates

Tax Rate	For Single Filers	For Married Filing Jointly	Head of Household
10%	$0 to $11,925	$0 to $23,850	$0 to $17,000
12%	$11,925 to $48,475	$23,850 to $96,950	$17,000 to $64,850
22%	$48,475 to $103,350	$96,950 to $206,700	$64,850 to $103,350
24%	$103,350 to $197,300	$206,700 to $394,600	$103,350 to $197,300
32%	$197,300 to $250,525	$394,600 to $501,050	$197,300 to $250,500
35%	$250,525 to $626,350	$501,050 to $751,600	$250,500 to $626,350
37%	$626,350 or more	$751,600 or more	$626,350 or more

Standard Deduction and Personal Exemption

The standard deduction will increase by $400 for single filers and by $800 for joint filers (Table 2). Seniors over age 65 may claim an additional standard deduction of $2,000 for single filers and $1,600 for joint filers.

The personal exemption for 2025 remains at $0 (eliminating the personal exemption was part of the Tax Cuts and Jobs Act of 2017 (TCJA).

Table 2. 2025 Standard Deduction

Filing Status	Deduction Amount
Single	$15,000
Married Filing Jointly	$30,000
Head of Household	$22,500

Alternative Minimum Tax

The alternative minimum tax (AMT) was created in the 1960s to prevent high-income taxpayers from avoiding the individual income tax. This parallel income tax system requires high-income taxpayers to calculate their tax bill twice: once under the ordinary income tax system and again under the AMT. The taxpayer then needs to pay the higher of the two.

The AMT uses an alternative definition of taxable income called alternative minimum taxable income (AMTI). To prevent low- and middle-income taxpayers from being subject to the AMT, taxpayers are allowed to exempt a significant amount of their income from AMTI. However, the exemption phases out for high-income taxpayers. The AMT is levied at two rates: 26 percent and 28 percent.

The AMT exemption amount for 2025 is $88,100 for singles and $137,000 for married couples filing jointly (Table 3).

Table 3. 2025 Alternative Minimum Tax (AMT) Exemptions

Filing Status	Exemption Amount
Unmarried Individuals	$88,100
Married Filing Jointly	$137,000

In 2025, the 28 percent AMT rate applies to excess AMTI of $239,100 for all taxpayers ($119,550 for married couples filing separate returns).

AMT exemptions phase out at 25 cents per dollar earned once AMTI reaches $626,350 for single filers and $1,252,700 for married taxpayers filing jointly.

Table 4. 2025 Alternative Minimum Tax (AMT) Exemption Phaseout Thresholds

Filing Status	Threshold
Unmarried Individuals	$ 626,350
Married Filing Jointly	$1,252,700

Earned Income Tax Credit

The maximum earned income tax credit (EITC) in 2025 for single and joint filers is $649 if the filer has no children (Table 5). The maximum credit is $4,328 for one child, $7,152 for two children, and $8,046 for three or more children.

Child Tax Credit

The maximum child tax credit is $2,000 per qualifying child and is not adjusted for inflation. The refundable portion of the child tax credit is adjusted for inflation and will remain at $1,700 for 2025.

Capital Gains Tax Rates and Brackets (Long-Term Capital Gains)

Long-term capital gains face different brackets and rates than ordinary income (Table 6.)

Table 5. 2025 Capital Gains Tax Brackets

For Unmarried Income Over	For Married Individuals Income Over	For Heads of Individuals Income Over	Filing Joint Returns Income Over
0%	0%	0%	0%
15%	$48,350	$96,700	$64,750
20%	$533,400	$600,050	$566,700

Qualified Business Income Deduction (Sec. 199A)

The Tax Cuts and Jobs Act of 2017 (TCJA) includes a 20 percent deduction for pass-through businesses. Limits on the deduction begin phasing in for taxpayers with income above $197,300 (or $394,600 for joint filers) in 2025.

Unchanged for tax year 2025

By statute, certain items that were indexed for inflation in the past are currently not adjusted.

Personal exemptions for tax year 2025 remain at 0, as in tax year 2024.

The elimination of the personal exemption was a provision in the Tax Cuts and Jobs Act of 2017.

Itemized deductions.

There is no limitation on itemized deductions for tax year 2025, as in tax year 2024 and preceding, to tax year 2018. The limitation on itemized deductions was eliminated by the Tax Cuts and Jobs Act of 2017.

Lifetime learning credits.

The modified adjusted gross income amount used by taxpayers to determine the reduction in the Lifetime Learning Credit provided in Sec. 25A(d)(1) of the Internal Revenue Code is not adjusted for inflation for taxable years beginning after Dec. 31, 2020. The Lifetime Learning Credit is phased out for taxpayers with modified adjusted gross income in excess of $80,000 ($160,000 for joint returns).

Certain procedural matters pertaining to individual taxpayers are updated annually.

Rev. Procs. 2024-1, 2024-2, and 2024-3.

During early 2024, the IRS issued Rev. Procs. 2024-1, 2024-2, and 2024-3. Rev. Proc. 2024-1 is a revised procedure for issuing letter rulings. The major changes from Rev. Proc. 2023-1 are mainly for corporations. However, income tax determination requests to the IRS Small Business/Self-Employed or Wage and Investment divisions can now be submitted only by electronic facsimile. The electronic facsimile rule also applies to determination letters for estate and gift tax matters, employment taxes, and excise taxes. All user fee payments must be submitted through pay.gov. Most user fees are unchanged from Rev. Proc. 2023-1, except for user fees for the four types of advance pricing agreement requests, which all increased by more than 6%.1

Rev. Proc 2024-2, with revised IRS procedures for furnishing technical advice, was not changed significantly from Rev. Proc. 2023-2.

Rev. Proc. 2024-3 updates the “no rule” listing. Rev. Proc. 2023-3 and Rev. Proc. 2013-32 were superseded; Rev. Proc. 2017-52 was modified. The 2024 version eliminates many no-rule items from the prior versions and indicates, among other issues, that the Sec. 1202(e) “active business” requirement for corporations for purposes of the partial exclusion of gain from small business stock is under study and that no rulings will be issued until the Service resolves the issue.2

Sec. 25C: Energy-efficient home improvement credit

Treatment of energy-efficient home rebates: The IRS released an announcement and news release stating that rebates for the purchase of energy-efficient homes generally will not be included in income for taxpayers but will reduce the basis of the home.3

Proposed regulations under Sec. 25C: The IRS announced in a notice4 that proposed regulations will be forthcoming to implement the product identification number (PIN) requirement for the Sec. 25C energy-efficient home improvement credit that applies to qualifying property placed in service after Dec. 31, 2024. The notice provided information regarding the PIN requirement and requested comments before the regulations are proposed.

TAX CASES AND RULINGS

Secure 2.0 Guidance:

The IRS used a question-and-answer format to provide guidance9 for 12 provisions of the SECURE 2.0 Act (which was enacted in December 2022).10 Section II. A of the notice deals with SECURE 2. 0 Section 101, concerning cash or deferred retirement plans and new automatic enrollment requirements. Section II. B of the notice addresses Section 102 of SECURE 2.0, which enacted an increased small-employer pension plan startup cost credit and other provisions relating to small employers under Sec. 45E. Notice Section II.C discusses Section 112 of the act, which enacted new Sec. 45AA, which provides a military spouse retirement plan eligibility credit for small employers. Notice Section II.D deals with Section 113 of SECURE 2.0, providing guidance on the definition of and rules regarding a de minimis financial incentive that will not violate the contingent-benefit rule.

Section II.E of the notice discusses Section 117 of SECURE 2.0. This section allows for additional employer contributions to a Savings Incentive Match Plan for Employees (SIMPLE) individual retirement account (IRA) or SIMPLE 401(k) plan by increasing the annual salary reduction/elective contribution limit and the limit on additional catch-up contributions beginning at age 50. The notice defines which employers are eligible and gives notification requirements.

Notice Section II.F provides guidance on Section 326 of SECURE 2. 0, which provides a new exception to the 10% penalty for early retirement plan withdrawals for terminally ill individuals. This section of the notice defines who is a “terminally ill individual” and specifies the timing and content of the required physician certification.

Before SECURE 2.0, an employer offering a SIMPLE plan was not allowed to adopt a qualified retirement plan.

Section II.G of the notice covers Section 332 of SECURE 2.0, which allows the employer to terminate the SIMPLE plan and roll over the benefits to a safe-harbor 401(k) plan even if some employees have been in the plan less than two years. Notice Sections II. H–J provide guidance on SECURE 2. 0 Sections 348, 350, and 501, which provide rules preventing qualified plans from failing to qualify under the Internal Revenue Code. Guidance for SECURE 2. 0 Section 601, which allows an employee covered by a SEP or SIMPLE IRA plan to designate that plan contributions be made to a Roth IRA instead of a traditional IRA, is covered in Section II. K.

Notice Section II.L discusses Section 604 of SECURE 2.0, which changed the requirement that employer matches or contributions be allocated to the deferral portion of a 401(k) plan with a Roth feature.

Now employees can elect to have those employer amounts allocated to the Roth portion of the plan. The notice provides that although these amounts are taxable, they are not wages for employment tax purposes.

Sec. 401: Qualified pension, profit-sharing, and stock bonus plans

Recent guidance has addressed distributions from inherited retirement accounts, part-time employees' eligibility to contribute to a 401(k) plan, emergency distributions from retirement accounts during federally declared disasters, and other matters.

Required distributions from inherited retirement accounts: The SECURE Act25 imposed a 10-year rule for taking distributions from inherited retirement plan accounts and IRAs, effective for deaths after 2019. Under the rule, "noneligible" beneficiaries (i.e., beneficiaries of a decedent other than a spouse, minor child, or certain others) must distribute the entire inherited account within 10 years of the decedent's death.

Proposed regulations implementing the 10-year rule were not issued until February 2022. Under a provision contained in them, noneligible beneficiaries of those decedents who were taking required minimum distributions (RMDs) before their death must take RMDs for nine years and liquidate the account in the year of the 10-year anniversary of the death, if not before. The proposed regulations would have exposed those beneficiaries to penalties for failure to take RMDs for 2021, which was before they knew of this requirement. In response to commenters who pointed this out, the IRS then issued Notice 2022-53, which waived the 50% excess accumulation excise tax under Sec. 4974 for 2021 and provided that no RMD would be required for noneligible beneficiaries in 2022 and, in addition, stated that final regulations would apply no earlier than 2023. Notice 2023-54 was issued in 2023

to put off the RMD requirement yet another year and indicated that final regulations would not apply before 2024.

Disaster relief distributions from retirement accounts:

In SECURE 2.0, Congress provided permanent rules allowing certain individuals affected by federally declared major disasters to take distributions from retirement plans and IRAs as well as retirement plan loans. FAQs were released May 3, 2024, as guidance.29 As with some earlier short-term disaster relief provisions and the COVID-19-related distributions under the CARES Act,30 withdrawals from plans are taxed one-third per year for three years, starting with the year of the disaster, and the amounts can be repaid to the retirement arrangement. The distributions are taxable, but $22,000 of them are exempt from the 10% Sec. 72(t) penalty. In addition, employee loans for disaster relief can have a year off from their five-year payment schedule and may be allowed for higher amounts than standard employee plan loans.

Notice 2024-35

On April 16, 2024, the IRS issued Notice 2024-35 to further delay the onset of RMDs for beneficiaries subject to the 10-year rule for another year, and this time, the Service indicated that final regulations are anticipated to apply in 2025. In each instance of deferring the RMD requirement, the IRS has waived the Sec. 4974 excise tax as well.

Sec. 32: Qualifying child is necessary for EITC:

In a Tax Court case, Turner, T.C. Memo. 2024-20, the taxpayer was the court-appointed guardian of her minor grandson since 2007. In 2020 she filed her income tax return as a head of household and claimed the earned income tax credit (EITC). The grandson was not employed in 2020, and the taxpayer paid many of his expenses, but her grandson resided with her only 60 days that year. The Tax Court noted that she met some of the Sec. 152(c) requirements for the grandson to be a qualifying child, which include the age requirement, the relationship requirement, and the support requirement (the child must not furnish more than 50% of his or her own support during the tax year).

However, the grandson did not meet an additional requirement of having the same principal place of abode as the taxpayer for more than one-half of the tax year.

The taxpayer not only lost the EITC because the child did not meet the qualifying child requirements; she also was not able to use a higher standard deduction amount and the more favorable tax brackets for a head of household, the court held.

Sec. 36B: Refundable credit for coverage under a qualified health plan

In Blas, T.C. Memo. 2023-132, the Tax Court found that the taxpayer must repay the advance premium tax credit (APTC) paid on his behalf because his circumstances had

changed in the tax year the APTC was paid.6 When the taxpayer applied for health insurance through the federal Health Insurance Marketplace website in November 2013, he was unemployed and did not have health insurance.

On his application, he noted his household income was $15,000. As a result, he qualified for the APTC benefit. He enrolled in a health plan with coverage starting in January 2014. The health plan sent him a thank-you letter and insurance card. In December 2013 he secured employment and was paid wages of $82,000 during 2014. He never reported the wages to the Marketplace.

The taxpayer did not receive health insurance from his new employer and did not have Medicare or TRICARE cover-age in 2014. The petitioner's Marketplace coverage continued throughout 2014, but because the APTC payments covered his insurance premiums, he never received any bills. He did, however, receive other correspondence and bills for the 2015 coverage year requesting payment of outstanding insurance premiums for his 2015 health coverage. He also received a Form 1095-A, Health Insurance Marketplace Statement, and a letter informing him he was required to file Form 8962, Premium Tax Credit (PTC), with his 2014 federal income tax return. When he filed his 2014 return, he reported an adjusted gross income (AGI) of $83,742, which included wages of $82,000. He did not attach Form 8962 to his return.

His return was examined in 2016, and the IRS asked him to complete and file Form 8962. The IRS determined a deficiency in the amount of his APTC payments, $8,328.

In the Tax Court proceedings, the taxpayer argued that the IRS had the burden of proof and production to show that the APTC payments were made on his behalf. The Tax Court disagreed, finding that the thank-you letter, insurance card, and the Form 1095-A were sufficient proof that he received coverage through the Marketplace for which the APTC payments were made. The court further held the taxpayer was not entitled to any PTC for 2014 and sustained the deficiency.

Sec. 61: Gross income defined.

A recent Tax Court case, Aulisio, T.C. Memo. 2024-29, illustrates a range of issues related to income recognition, business expense and other deductions, and claiming a net operating loss (NOL). The taxpayer, Anthony Aulisio Jr., was a CPA who also attended law school. During 2015, Aulisio operated a CPA business and an alleged equipment leasing business. He reported $10 of taxable income on his original 2015 individual income tax return. The IRS initially determined a deficiency of $14,878 and a Sec. 6662(a) accuracy related penalty of $2,976, based on third-party reporting of unreported income totaling more than $64,000. Subsequently, the IRS alleged that Aulisio had additional income exceeding $101,000, based on the amount that he reported on an amended 2015 tax return.

The matters for decision by the court were whether for the 2015 tax year Aulisio

- had $22,492 of unreported interest income and an additional $11,055 in gross receipts, as reported on his 2015 amended return Schedule C, Profit or Loss From Business, from his CPA business;
- was entitled to deduct expenses of $44,950 associated with his CPA business;
- was entitled to deduct $80,000 of Schedule C expenses associated with his equipment leasing business;
- was entitled to deduct an NOL of $437,141;
- was entitled to deduct $28,336 of home mortgage interest reported on Schedule A, Itemized Deductions; and
- was entitled to deduct $14,114 of other itemized deductions, including property taxes on his principal and secondary residences and a charitable contribution.

Gross receipts from CPA business and interest income**:** Aulisio argued in Tax Court that the $22,492 of interest income reported on his amended return was not interest income but instead was nontaxable proceeds from a loan from a trust he controlled that was not includible in gross income.

He also claimed that the income from his CPA business he reported on his 2015 amended return ($123,180) was overstated by $11,055. With respect to the interest income, he testified that his friend and assistant who had prepared his return (who was dead by the time of trial) had inadvertently mischaracterized the loan proceeds as interest on his return. Similarly, he claimed that a schedule allegedly prepared by the same assistant proved that the CPA business income amount that he had included on his amended return was overstated.

The Tax Court found that the statements on Aulisio's amended return that his CPA business had gross receipts of $123,180 and that he had $22,492 of interest income were admissions that could be overcome only with cogent evidence.

The court held that Aulisio had not introduced cogent evidence to overcome the admission on his amended return that the gross receipts from the CPA business and the interest income were includible in his gross income.

NOL deduction**:** On his 2015 amended return, Aulisio claimed an NOL deduction of $437,141, whereas he had claimed none on his original return. He testified that the NOL

originated from equipment that his business leased to companies that had filed for bankruptcy, and the bankruptcy court gave the equipment to the lessees' creditors.

Aulisio provided no documentation regarding the bankruptcy proceedings**.** Furthermore, the date on which the losses arose was unclear. At varying times during the proceedings, Aulisio claimed the NOL originated in 2001, 2008, 2009, and/or 2013. The IRS asserted that he failed to provide sufficient documentation to substantiate the initial loss, including when it originated and how the NOL was used and calculated in the intervening years. The Tax Court agreed, determining that Aulisio was not entitled to deduct the claimed NOL carryforward deduction for 2015.

Qualified residence interest. Under Sec. 163(h)(2)(D), individuals are allowed a deduction for qualified residence interest. A *"qualified residence"* means a taxpayer's principal residence within the meaning of Sec. 121 and one other residence selected and used by the taxpayer as a residence.8 Aulisio asserted that he was entitled to a deduction of $42,500 for qualified residence interest paid on his primary home in Laguna Beach, Calif. He did not claim this deduction on any 2015 income tax return and raised it for the first time during the Tax Court proceedings. He provided substantiation for payments totaling $14,164. The court limited him to a deduction in this amount since he failed to offer bank records, statements, canceled checks, or other records to support the additional deduction.

Real property taxes: Aulisio asserted a deduction for real property taxes totaling $2,868 related to his primary home in Laguna Beach and a deduction for real property taxes totaling $10,476 related to his secondary home in San Bernardino County, Calif. During the proceedings, he was able to substantiate that he paid $1,084 for the San Bernardino County property but nothing else. Consequently, the court limited his deduction to this amount.

Charitable contributions: Aulisio did not claim a charitable contribution deduction on any 2015 income tax return. According to his pretrial memorandum, he claimed a $500 deduction for a charitable contribution to the Friends of the Los Angeles Philharmonic. He introduced into evidence a letter stating he was at the organization's "$500 membership level." The Tax Court held that this letter did not satisfy the requirements of Sec. 170(f)(8) for a contemporaneous written acknowledgment. Notably, it did not state whether the donee organization provided any goods or services in consideration for the contribution and did not include a description and good-faith estimate of the value of any goods and services that were provided. As a result, Aulisio was not entitled to a charitable contribution deduction.

Sec. 72(t) penalty:

In 2018, the taxpayer in Kohl, T.C. Summ. 2024-4, withdrew money from her IRA to pay rent and avoid eviction. She contended that the 10% penalty should not apply, based on the exception for withdrawals for emergency expenses as enacted as part of SECURE 2.0.12

The law change applies only to withdrawals from qualified retirement plans made after Dec. 31, 2023, so the Tax Court held that it did not prevent the 10% penalty from applying to her.

Failure to Report

The taxpayer in Scott, T.C. Memo. 2023-141, failed to report dividends, capital gains, and a retirement distribution on her 2019 return.

In box 7 of the Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., she received, the distribution was coded "1," meaning that there was no known exception to her distribution of $14,386. The instructions to Form 1099-R state that this code should be used if the participant has not reached 59½ years old.

Scott's Tax Court petition did not dispute any of the amounts shown by the IRS in the audit report, saying only that she disagreed with the IRS's determination because her income had been approximately the same amount for 10 years and that "retirement investments are taxed before being applied to the 401(k) plan." In the Tax Court proceedings, the IRS requested an admission from Scott that she had received the items of unreported income, but she did not reply to the request.

The Tax Court found that the IRS had met its burden of showing that Scott had received the unreported income by providing the court the Form 1099-DIV, Dividends and Distributions, with the ordinary dividends and capital gains distributions and the Form 1099-R with the retirement plan distribution. Because Scott did not contest the IRS's determinations of unreported income in her petition and did not reply to the IRS request for admissions, the court found she had conceded the issue.

The Tax Court further held that the 10% penalty applied to Scott. The retirement account trustee's records showed she was under the age of 59½, which she did not dispute in her petition or provide evidence to the contrary; thus, the court found that she did not qualify for an exception to the early distribution penalty.

Sec. 165: Losses

Two Tax Court cases were instructive regarding issues encountered in attempting to deduct theft losses, including the timing of the loss and meeting the definition of a qualifying theft.

Theft loss I — fraudulent mortgage scheme:

In Giambrone, T.C. Memo. 2024-14, Michael and William Giambrone had a successful mortgage finance business, and in 1998 they decided to start a federally chartered savings and loan institution. This type of entity, also called a thrift, is overseen by the Office of Thrift Supervision (OTS). Although they had outside investors, the brothers invested more capital to cover increasing losses. In 2007 OTS launched an examination of the thrift, which eventually led to operating restrictions.

In looking for additional capital, they were referred to Lee Bentley Farkas, who had a good reputation in the mortgage industry. They sold 75% of the business to a Farkas entity. This caused the Giambrones' share of ownership of the business to be reduced from 54% to approximately 14%. In 2009, it came out that Farkas was involved in a fraud scheme, and the thrift was closed. Farkas was ordered to pay restitution to 20 victims, but the Giambrones were not one of them.

The Giambrones claimed theft loss deductions of 95% of the value of their investments in their thrift business on their 2012 federal income tax returns. Among other things, the brothers premised their claimed deductions on Rev. Proc. 2009-20, which provides "an optional safe harbor treatment for taxpayers that experienced losses in certain investment arrangements discovered to be criminally fraudulent."

The IRS moved for summary judgment on the issue of whether Rev. Proc. 2009-20 applied, and the Tax Court granted the motion.15 The court found that the requirement in Rev. Proc. 2009-20 that safe-harbor treatment must be elected on a taxpayer's return in the year of discovery was not met. Because Farkas was indicted in 2010, that was the year of discovery in which the safe-harbor treatment was required to be elected. The brothers did not report the loss on their 2010 returns but only on their 2012 returns. The court left all other questions in the case, including whether the Giambrones qualified for a Sec. 165 theft loss deduction, to be decided in further proceedings.

In the subsequent proceedings, the brothers still needed to show that they met all of the requirements for a theft loss and that it had been claimed in the proper year. They claimed that they suffered a theft of their controlling interest in the thrift. The Tax Court looked to Illinois law to see if their loss of their controlling interest could be considered a theft loss and determined that it could not.

With regard to the year of loss, the court, having previously held that the year of discovery of the theft was 2010, considered whether the Giambrones had a reasonable prospect of recovery of their theft loss from Farkas or the FDIC (which had assets of the business in receivership) after 2010 that would allow them to claim the loss in 2012. Because Farkas was ordered to pay restitution in 2011 that was greater than his entire net worth, and the

Giambrones were not named as victims who were entitled to restitution, the court determined they had no reasonable prospect of recovery from Farkas.

The court further found that the Giambrones had no reasonable chance of recovery of any assets from the FDIC. Therefore, reporting the loss in 2012, when the Gambriones had no reasonable prospect of recovery after 2010, was incorrect. Since the brothers failed to prove that they suffered a theft loss or that they claimed the loss in the year of discovery, the court sustained the IRS's disallowance of the theft loss deduction and its deficiency determination.

Theft loss II— reduction in cash value of life insurance:

The taxpayer in Pascucci, T.C. Memo. 2024-43, Christopher Pascucci, had invested in 16 flexible premium variable life insurance policies beginning in 1997. Variable life insurance policies offer separate accounts that a portion of the premiums paid on the policies are invested in. Pascucci's premiums for all of his policies could be invested without a guarantee that the death benefit would be larger than the policy amount.

Beginning in 2001, the investments could include limited partnership interests, and Pascucci opted to allocate his premiums to separate accounts that the insurance company invested in a limited partnership. It turned out that the limited partnership had investments in feeder funds that in turn invested all their money with Bernard L. Madoff Investment Securities (BLMIS). The investments in the feeder funds became worthless in 2008 when the Ponzi scheme involving BLMIS unraveled, causing a reduction in the value of insurance policies owned by Pascucci. Pascucci claimed a theft loss deduction for 2008 for the reduction in value of the life insurance policies, which the IRS denied. The Tax Court agreed with the IRS, holding that the insurance companies, not Pascucci, owned the assets in the separate accounts at the time of Madoff 's theft.

Sec. 170(h): Qualified conservation contribution

Sec. 170(h) allows a charitable contribution for the fair market value (FMV) of a qualified conservation contribution, which is defined as "a contribution — (A) of a qualified real property interest, (B) to a qualified organization, (C) exclusively for conservation purposes." The Internal Revenue Code and accompanying Treasury regulations delineate the requirements that must be met before a contribution is deductible. During this update period, the Tax Court ruled on several cases related to conservation easement contributions.

In Carter, T.C. Memo. 2023-133, taxpayers Nathaniel Carter and Ralph Evans were equal partners in Dover Hall Plantation LLC, which donated a 500-acre conservation easement to the North American Land Trust on property in coastal Georgia. The conservation deed retained several rights for the donors, including rights to build residential units on the

donated property. The partnership claimed a $14,175,000 deduction for the easement donation on its 2011 partnership tax return. Each taxpayer then claimed his 50% share of the deduction on his 2011 individual income tax return.

The IRS disallowed in full the charitable contribution deductions on the taxpayers' individual returns and also assessed gross-valuation-misstatement penalties. The initial court opinion in 202019concluded that the taxpayers were not entitled to charitable contribution deductions because the easement was not a "qualified real property interest" within the meaning of Sec. 170(h) 2) . This was because the restrictions it imposed on the partnership's use of the property were not "granted in perpetuity" as a result of the retained rights granted to the donors. The court also concluded that the taxpayers were not subject to gross-valuation-misstatement penalties under Secs. 6662(a), (b)(3), (e) , and (h) for the years in issue because the IRS had not met its burden of demonstrating compliance with the supervisory approval requirement of Sec. 6751(b). Specifically, the revenue agent who made the initial penalty determination had communicated that determination to the taxpayers before his supervisor had approved it. Subsequent rulings forced the Tax Court to reconsider its position on both issues.

First, the Eleventh Circuit reversed the Tax Court's 2020 holding regarding the Carter/Evans charitable contribution deductions,20 in light of its decision in Pine Mountain Preserve, LLLP.21 In Pine Mountain, the Eleventh Circuit determined that an easement granted in perpetuity over a defined conservation area satisfied the Sec. 170(h)(2)(C) requirement, regardless of a reservation of rights to build homes. Second, it reversed the Tax Court's 2020 holding regarding the written supervisory approval requirement based on Kroner,22 in which the Eleventh Circuit rejected the Tax Court's interpretation of Sec. 6751(b)(1), concluding that IRS supervisory approval of an initial determination to assess penalties is timely as long as it comes before assessment. As a result, the case was remanded to the Tax Court.

On remand, the court found that the easement documentation and protectedin- perpetuity requirements were met and that the taxpayers were in fact entitled to a charitable contribution deduction equal to the FMV of the easement at the time of the contribution. However, the court also found that the FMV was radically lower than the amount they reported. Whereas the taxpayers initially valued the easement at $14,175,000, the IRS valuation expert determined that it was worth $1 million. The court sided with the IRS appraiser, finding that the taxpayers' appraisal was flawed, inconsistent, and ultimately unreliable.

The court also upheld the IRS's accuracy-related gross-valuation-misstatement penalty since the Service had complied with the written supervisory approval requirement of Sec. 6751(b) in light of the Eleventh Circuit's ruling in Kroner.

Sec. 130: Certain personal injury liability assignments

IRS Letter Ruling 202416001 provides favorable interpretations for personal injury structured settlement agreements, allowing continued use of indexed annuities as tax-favored payments to claimants. The IRS concluded that the periodic payments are fixed and determinable, as required under Sec. 130(c)(2)(A), and the contract will not fail to be a "qualified funding asset" within the meaning of Sec. 130(d) despite the value potentially increasing in the stock market.

Sec. 130 provides that amounts received for agreeing to a qualified assignment (any assignment of a liability to make periodic payments as damages or as compensation under a workers' compensation act or on account of personal injury or sickness) are excludable from income to the extent the amount does not exceed the aggregate cost of any "qualified funding assets." This income exclusion is essential for the widely used process of assigning settlements to third parties, which in turn pay personal injury claimants a steady income stream over time, versus a lump-sum payment. While the letter ruling expresses no opinion on the tax consequences of payments to the claimant, periodic payments in this type of arrangement are generally excludable from gross income under Sec. 104(a)(1) or (2).

Sec. 274: Disallowance of certain entertainment, etc., expenses

Among the most common — and often problematic — business expense deductions are those related to automobile travel. In Chappell, T.C. Summ. 2024-2, the taxpayer was a tax return preparer and operated a sole proprietorship. The IRS audited her 2015 return and disallowed some expenses reported on her Schedule C. The IRS conceded all previously disallowed expenses, except for phone and transportation expenses. The taxpayer petitioned the Tax Court to redetermine these remaining expenses.

Under Sec. 274(d), taxpayers must meet substantiation requirements to deduct certain expenses under Sec. 162, including those for listed property under Sec. 280F(d)(4), which includes passenger automobiles. Taxpayers must substantiate (1) the amount of the expense; (2) the amount of total use and business use of the listed property during the year; (3) the date of each expense or the use of the listed property; and (4) the business purpose of the expense or use. A contemporaneous log as well as supporting evidence must be maintained.

For business trips, the taxpayer used a cellphone application called MileIQ to record her car trips. MileIQ used GPS technology on her phone to track starting and stopping points and mileage. At the end of each trip, she would designate the trip as business or personal. MileIQ compiled the information into a spreadsheet. The MileIQ log showed 13,585.8 miles as business and 1,619 as personal but did not show the purpose of each trip.

Before trial, the taxpayer prepared an edited version of the MileIQ log, and the number of business miles listed was less than the MileIQ log by 1,987.6 miles. The modified log included a short description of the purpose of each trip. At trial, the taxpayer's receipts for fuel, insurance, etc. were not accepted because several other people who worked for her business had use of her cards and may have made personal use of them, since this was how she paid some of her employees. She had one car, and the receipts often showed two or three same-day gas purchases on days when the mileage logs did not show an excessive number of miles being driven. Because of the inconsistencies in the records, the court allowed the taxpayer a standard mileage rate deduction for the trips where the business purpose was evident, instead of determining the deduction based on the actual vehicle expenses.

Qualified vs. nonqualified plan:

In Palaniappan, No. 2:22-cv-01685 (D.C. Ariz. 3/28/24), the taxpayer chose to participate in his hospital employer's Sec. 409A deferred compensation plan, which was allowed only if the employee no longer contributed to the hospital's 401(k) plan. Five years later, the hospital filed for bankruptcy. Believing that the taxpayer and some others were not qualified to participate in the 409A plan, and seeking to protect their funds from the hospital's bankruptcy creditors, the hospital liquidated the 409A plan and made secured claim distributions to the nonqualified participants.

The taxpayer objected to this treatment and requested that his share of the 409A funds be transferred to the hospital's 401(k) plan. Meanwhile, his benefits were distributed, less 20% federal withholding. The bankruptcy court said it could not order that the funds from his nonqualified plan (409A) be deposited into a qualified plan and that taxes were properly withheld. It also held that he had been given enough disclosure that the 409A plan was not a qualified plan when he voluntarily decided to participate in it.

At the same time, the taxpayer filed an ERISA breach of fiduciary duty claim against the hospital. He was awarded over $500,000 in damages. Next, he amended his 2016 Form 1040, U.S. Individual Income Tax Return, claiming that the taxes withheld from the distribution were in error. The district court rejected his contention based on the doctrine of double recovery and on the grounds that he could not relitigate a claim that had already been decided in the bankruptcy proceeding.

Long-term, part-time employee rules: The SECURE Act allowed long-term, part-time employees to participate in 401(k) plans, effective Jan. 1, 2024. Before that, only employees who annually worked 1,000 hours or more, were 21 years of age or over, and completed 12 months of service were eligible to participate in 401(k) plans. Congress loosened these requirements in the SECURE Act by providing that 500 hours of service

annually, being age 21 or over, and having three consecutive years of service (two for plan years beginning after 2024) would make these part-time employees eligible for a 401(k) plan, but the employer was not required to make matching contributions for them.

In addition, service before 2021 was not counted toward eligibility under this provision. Additional changes were made in SECURE 2.0. Proposed regulations28 were issued Nov. 24, 2023, to provide information necessary for implementation of the change.

Sec. 404: Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan

In Jadhav, T.C. Memo. 2023-140.a case involving questionable deductions, the taxpayer was a Ph.D. chemist who had a full-time job but also operated a sole proprietorship that reported on Schedule C. The sole proprietorship had a Sec. 401(k) plan that covered the taxpayer's wife and their two sons, both of whom attended college during 2014, the contribution year. The taxpayer paid a consultant $50,000 for an "income tax plan," which involved converting the Schedule C business to an S corporation and renting the couple's personal residence to the corporation at FMV for 14 days or less, for a corporate deduction with no corresponding income. The plan also involved the creation of a C corporation that would deduct medical and disability plan payments, overtime and weekend meals for employees, meals for the family "for the convenience of the employer," tuition for both sons, deferred compensation, and salaries for the children.

The IRS disallowed almost all the expenses and questioned whether the sons were actually employees. However, the Tax Court believed the taxpayer's explanation that this was a family business and found that the payments to the sons' retirement accounts were supported by documents. The retirement plan contributions were allowed as deductions for 2014, but substantially all additional expenses were not. The taxpayer tried to avoid penalties, saying he relied on the CPA hired to prepare the returns, but the court found that there was insufficient evidence that he provided the CPA all relevant information and relied on his professional judgment in good faith.

Sec. 408: Individual retirement accounts

Recent administrative and court rulings addressed the effect of naming a trust as an IRA beneficiary and a convicted felon's forfeiture of an IRA.

Trust named as beneficiary:

In IRS Letter Ruling 202404003, the decedent chose to name as an IRA beneficiary a trust established by the decedent and the decedent's spouse. Upon the decedent's death, the custodian rolled over IRA benefits to an inherited IRA for the trust. The spouse was the sole trustee and beneficiary of the trust and had the ability to distribute all assets to that spouse

during the spouse's lifetime. The IRS held that the spouse would be treated as receiving the IRA directly from the decedent and not the trust and could accomplish a tax-free rollover.

Criminal forfeiture of an IRA:

In Hubbard,, T.C. Memo. 2024-16, the taxpayer was a pharmacist who was convicted of various crimes involving distributing controlled substances and sentenced to 30 years in prison. The taxpayer's assets were also condemned and forfeited to the government, including his T. Rowe Price IRA. He did not file a tax return for the year of the forfeiture, but the IRS filed a substitute for return for him based on the Form 1099-R from T. Rowe Price. The Service took the position that, because his funds were criminally forfeited to the United States, he had constructively received them, and they were therefore includible in his gross income.

The taxpayer filed a Tax Court petition disputing the tax assessed. He contended that case law on forfeitures dealt with cases where the convicted person turned the retirement assets over to the United States voluntarily, while his own forfeiture was involuntary.

Rejecting his argument, the Tax Court held that the forfeitures in the prior case law were not exactly voluntary, and whenever the IRS levies a retirement plan, the owner is taxed on constructive receipt. Hubbard was taxable on the amount of the forfeiture and was subject to penalties for failing to file a return and for failure to pay the tax. The court found no reasonable cause to excuse his actions.

Sec. 469: Passive activity losses and credits limited; Sec. 1411: Imposition of tax

In Senty, No. 22-cv-283-wmc (W.D. Wisc. 12/15/23) the taxpayers sought a refund of Sec. 1411 net investment income tax that the IRS had assessed against them on audit. The case rested on whether the taxpayer husband, James Senty, materially participated in three entities, because if he did and could adequately document it, the income he received from them would be exempt from net investment income tax. Filing a motion for summary judgment, the taxpayers claimed that Senty met the material-participation requirement under Temp. Regs. Sec. 1.469-5T(a)(4)'s "significant participation activity" test, which allowed him to aggregate the time he spent on each 100-hour-plus-per-year activity, such that the combined hours exceeded 500, resulting in material participation under Sec. 469.

Senty, a businessman, stated that during the years in question, 2014 and 2015, he worked 65 to 70 hours a week. There were three entities for which he claimed to have worked enough hours to meet the significant-participation-activity test. The problem for Senty was the lack of documentation. Temp. Regs. Sec. 1. 469-5T(f)(4) explains how a taxpayer may prove participation in activities:

The extent of an individual's participation in an activity may be established by any reasonable means. Contemporaneous daily time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means for purposes of this paragraph may include but are not limited to the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries.

Unfortunately for Senty, he stated that he did not maintain a work calendar, appointment book, log, journal, time sheet, or any other document to keep track of hours and the type of work he did. He also rarely used email or text for work, and though he claimed he did business through phone calls, he did not produce any phone records to substantiate his time worked.

The courts have allowed for a post-event re-creation of hours in cases such as Tolin, T.C. Memo. 2014-6534. However, the narrative summary of tasks done in that case included hours worked on specific activities and was based upon "telephone records, credit card invoices, and other contemporaneous materials." Additionally, in Tolin, there was "a significant amount of credible third-party witness testimony."

Because Senty did not produce a similar summary with objective evidence to support his narrative, the court denied the taxpayers' motion for summary judgment. Still, the court gave the couple one month to submit adequate evidence of material participation, indicating in the opinion that judgment would be entered for the government otherwise.

Of note in the case, the IRS also argued that many of the activities that Senty performed were related to his role as an investor in the entity and thus did not count toward material participation. The court did not address the issue, finding it did not need to do so.

Sec. 4973: Tax on excess contributions to certain tax-favored accounts and annuities

In two cases involving the same taxpayer, Couturier, T.C. Memo. 2024-6 and 162 T.C. No. 4 (2024), the Tax Court decided matters relating to the taxpayer's overfunding of his IRA.

The case dates to 2004, when the taxpayer, the president of a manufacturing company, received a $26 million buyout in exchange for stock that he held in an employee stock ownership plan and certain other interests. He rolled over the buyout proceeds into his IRA that year. His 2004 return was not examined, but the Service later contended that he was liable for a 6% excise tax for overfunding his IRA by $25 million. The taxpayer asserted the statute of limitation and other defenses.

At an earlier stage of the litigation, the Tax Court explained that excess IRA contributions must be reported on Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and

Other Tax-Favored Accounts — which the tax-payer had failed to do. The court also noted that if Form 5329 is not attached to Form 1040 or sent separately to the IRS, the statute of limitation on the excess contribution penalty does not begin running.36

In the first 2024 opinion (issued Jan. 17, 2024),37 the court held that the 6% excise tax on excess contributions is a “tax,” not a “penalty,” and, consequently, no written supervisory approval was necessary under Sec. 6751(b). The court granted the IRS’s motion for partial summary judgment on the issue.

In the second 2024 opinion (issued Feb. 28, 2024),38 the taxpayer contended that, under the SECURE 2.0 Act, a finite statute of limitation should apply here and bar the collection of excess contribution penalties. In the act, passed in late 2022, Congress provided that the filing of an income tax return on Form 1040 will start the running of a six-year statute of limitation, even if no Form 5329 is filed.39 Unfortunately for the taxpayer, the court concluded here that the 2022 amendment did not apply retroactively to this case.

Sec. 6015: Relief from joint and several liability on joint return

In Rawat, T.C. Memo. 2024-56, the taxpayer sought innocent-spouse relief under Sec. 6015(f) for six tax years. Under Sec. 6015(f) the IRS may grant equitable relief to a requesting spouse if, considering all the facts and circumstances, it would be inequitable to hold the requesting spouse liable for any unpaid tax or deficiency.

A streamlined determination granting equitable relief under Sec. 6015(f) is available if the requesting spouse can establish that he or she (1) is no longer married to the non-requesting spouse, (2) would suffer economic hardship if relief were not granted, and (3) lacked knowledge or reason to know of the understatement at the time the return at issue was signed. See also Rev. Proc. 2013-34.

Relief may also be granted if, after weighing the seven equitable factors listed in Rev. Proc. 2013-34, the IRS determines it would be equitable to grant relief. Those factors are (1) the current marital status of the spouses; (2) whether the requesting spouse will suffer economic hardship if relief is not granted; (3) whether the requesting spouse knew or had reason to know of the item giving rise to the understatement; (4) whether either spouse has a legal obligation to pay the outstanding liability; (5) whether the requesting spouse significantly benefited from the understatement; (6) whether the requesting spouse has made a good-faith effort to comply with income tax laws in the years following the year for which relief is sought; and (7) whether the requesting spouse was in poor mental or physical health when the return at issue was filed, when the request for relief was made, or at the time of trial.

The Tax Court found that the taxpayer was not entitled to streamlined relief or relief under the equitable factors. The court stated: “[I]n the light of her considerable income and

assets, knowledge and participation in the items giving rise to the understatement, and consistent record of noncompliance with tax law, we find it would not be inequitable to deny relief."

Sec. 6654: Failure by individual to pay estimated income tax

IRS interest rates are high by recent historical standards (e.g., for the calendar quarter beginning Jan. 1, 2024, the underpayment rate for individual taxes was 8%).42Rev. Rul. 2024-6. Thus, interest on underpayments of estimated taxes can add significantly to taxpayers' deficiencies.

In addition, a recent Tax Court case, Standifird, T.C. Memo. 2024-30, provides a reminder that even if no tax return is filed for several years, the requirement to make estimated tax payments (if liable) still exists. In this case, the taxpayer did not file individual tax returns for four years or make estimated tax payments for those years. The IRS determined income tax deficiencies and asserted additions to tax under Secs. 6651(a)(2) (failure to pay), 6651(f) (fraudulent failure to file), and 6654 (failure to pay estimated taxes). The IRS produced the taxpayer's transcripts confirming that no tax returns were filed, and the court concluded that the taxpayer was liable for the additions to tax, including the estimated tax penalties, for not making quarterly estimated payments.

Estate Tax Developments

Changes Exemption Amounts - Inflation adjustments

The US Internal Revenue Service (IRS) has announced that the annual gift tax exclusion is increasing in 2025 due to inflation. The exclusion will be $19,000 per recipient for 2025—the highest exclusion amount ever.

Annual Git Tax Exclusion

Each year, the IRS sets the annual gift tax exclusion, which allows a taxpayer to give a certain amount (in 2025, $19,000) per recipient tax-free without using up any of the taxpayer's lifetime gift and estate tax exemption (in 2025, $13.99 million). For married couples, this means that they can give $38,000/year per recipient beginning next year.

For example, if a married couple has three children and five grandchildren, they may transfer $304,000 in 2025 to their descendants without touching their combined $27.98 million gift tax exemption, thus allowing them to transfer further substantial assets gift tax-free. Not only are the assets removed from the taxpayers' taxable estates, the assets' future appreciation also avoids gift and estate taxes.

Gifts to Non-Citizen Spouses

Generally, spouses who are both US citizens may transfer unlimited amounts to each other without incurring any gift tax, as any assets in excess of the couple's combined estate tax exemption ($27.98 million in 2025) will be taxed at the death of the surviving spouse, and transferring assets to the survivor only defers the tax that the IRS will eventually collect.

Gifts to a non-US citizen spouse, however, are limited. Since a non-US citizen spouse may not be subject to the US estate tax, one cannot transfer unlimited assets to a non-US citizen spouse since that transferred wealth could potentially avoid US estate taxation upon the non-US citizen spouse's death.

Thus, when the recipient spouse is not a US citizen, and regardless of whether the non-US citizen spouse is a resident or nonresident of the United States, the amount of tax-free gifts is limited to an annual exclusion amount.

For calendar year 2025, the first $190,000 of gifts to a spouse who is a non-US citizen are not included in the total amount of taxable gifts.

Estate and Gift Tax Exemption

If an individual gifts an amount that is above the annual gift tax exclusion, a portion of the individual's lifetime gift tax exemption ($13.99 million in 2025) will be used. The gift and

estate tax exemption are linked, meaning that the use of one's gift tax exemption will reduce the amount one may leave at death estate tax-free.

If an individual makes gifts in excess of the annual gift tax exclusion, a gift tax return will be due on April 15 the following year to report the gift (and track the amount of the lifetime exemption that has been used).

It should be noted that although the IRS has announced that the lifetime estate and gift tax exemption will increase to $13.99 million in 2025, under current law, that amount will be decreased by half at the start of 2026.

Potential sunset of higher estate/gift and GST exemptions

The impending sunset of the current estate, gift, and generation-skipping transfer (GST) tax exemptions at the end of 2025 is a critical issue for estate planners and their clients. The Tax Cuts and Jobs Act (TCJA)1 significantly increased these exemptions, allowing individuals to transfer up to $13.61 million and married couples up to $27.22 million over their lifetimes as of 2024 without incurring federal estate or gift taxes. However, unless Congress acts to extend these provisions, the exemptions will revert to their pre-TCJA levels of $5 million per individual and $10 million per married couple, adjusted for inflation, starting Jan. 1, 2026.

CASES AND RULINGS

Key items in the IRS Priority Guidance Plan

The 2023–2024 Priority Guidance Plan outlines key tax issues that Treasury and the IRS will address through various forms of published administrative guidance, including regulations and revenue rulings. For estate and gift tax planning, several items are particularly relevant:

- Regulations under Sec. 645 pertaining to the duration of an election to treat certain revocable trusts as part of an estate;
- Final regulations under Secs. 1014(f) and 6035 regarding basis consistency between an estate and a person acquiring property from a decedent;
- Regulations under Sec. 2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of Regs. Sec. 20.2010-1(c);5
- Regulations under Sec. 2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period;
- Final regulations under Sec. 2053 regarding the deductibility of certain interest expenses and amounts paid under a personal guarantee, certain substantiation

requirements, and the applicability of present-value concepts in determining the amount deductible; and

- Regulations under Sec. 2632 providing guidance governing the allocation of GST exemption in the event the IRS grants relief under Sec. 2642(g), as well as addressing the definition of a GST trust under Sec. 2632(c) and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining exemption.

New final GST exemption regulations

Final regulations have been issued providing guidance on when, and how, taxpayers can obtain an extension of time to make certain GST exemption allocations and elections under Sec. 2642(g) (1). T.D. 9996, 89 Fed. Reg. 37116. On and after May 6, 2024, relief under Sec. 2642(g)(1) no longer will be granted under Regs. Sec. 301.9100-3. Private letter ruling relief will instead be granted under Regs. Sec. 26.2642-7. While the proposed regulations prohibited relief to revoke a prior GST election, Prop. Regs. Sec. 26.2642-7(e)(1), REG-147775-06, issued in 2008.7 the final regulations removed this language, potentially allowing relief to revoke a prior erroneous GST "optin" or "opt-out" election.

Further, the final regulations provide additional details related to affidavits when requesting private letter ruling relief for GST purposes. The relief request process still requires a private letter ruling in most situations, and the user fee will likely be the same as for Regs. Sec. 301.9100-3 requests. Generally, to receive relief, the taxpayer must show that they acted reasonably and in good faith, that they are not attempting to benefit from hindsight, and that it would not prejudice the interests of the government if relief were granted.

Proposed foreign trust regulations

The IRS released proposed regulations on reporting transactions with foreign trusts.[8] These regulations clarify existing guidance but do not introduce major changes. They confirm reporting requirements for distributions, contributions, and loans involving foreign trusts. While some relief is offered for reporting certain pensions, broader penalty relief for reasonable-cause delinquencies is not included.

Increase in estate and gift filings and IRS examinations

The annual IRS Data Book offers a wealth of information and provides valuable insights into IRS enforcement activities, including audit rates and revenue collected from estate and gift taxes. The most recent IRS Data Book for the fiscal year ending Sept. 30, 2023, reveals a significant increase in estate- and gift-related filings in 2023 compared with 2022. Fiduciary

[8] REG-124850-08, 89 Fed. Reg. 39440.

income tax returns associated with trusts and estates saw a rise of over 13%.[9] Even more dramatic is the increase in 706-series forms. Estate tax and GST tax returns rose from 27,088 in 2022 to 49,633 in 2023, an 83% increase.[10] Gift tax filings climbed from 270,142 in 2022 to 516,991, a 91% increase.[11]

This surge suggests many taxpayers are taking proactive steps in estate planning, possibly due to concerns about the potential sunset of the current high estate and gift tax exemption. However, the increase in filings also presents a potential opportunity for the IRS. With more estate and gift tax returns on the table, the agency may see a ripe area for examination and potential tax revenue collection.

Anecdotally, the authors have seen a rise in estate and gift tax audits. The IRS Data Book reports on closed examinations, meaning audits that have concluded. This means that the data does not reflect the many ongoing audits for recent tax years. The most recent data only reports on tax years 2013–2021. Out of the 32,374 series 706 estate and GST tax returns filed for the 2021 tax year, only 10 of the 158 returns examined (of which 135 examinations were still in process) had resulted in no change.[12]

IRS guidance on related-party basis shifting and irrevocable grantor trusts

In an effort to crack down on tax-avoidance strategies, Treasury and the IRS issued a package of guidance on June 17, 2024, targeting "basis-shifting" transactions used by related parties. The first item in the package was Notice 2024-54, which announced that the IRS will propose two sets of regulations that aim to prevent tax-avoiding basis-shifting maneuvers within partnerships involving related parties (covered transactions). In the first set, the IRS intends to propose regulations under Secs. 732, 734(b), 743(b), and 755 that would (1) provide the required method of recovering adjustments to the bases of property held by a partnership, property distributed by a partnership, or both, arising from covered transactions; (2) provide rules governing the determination of gain or loss on the disposition of such basis-adjusted property; and (3) include similar transactions involving tax-indifferent parties (for example, certain foreign persons, a tax-exempt organization, or a party with tax attributes that make it tax-indifferent) rather than related parties. In the second set, the IRS intends to propose regulations that would provide for single-entity treatment of members that are partners in a partnership, so that covered transactions cannot shift basis among group members and distort group income.

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[9] IRS Data Book, 2023, Table 2, Number of Returns and Other Forms Filed, by Type, Fiscal Years 2022 and 2023.

[10] Id.

[11] Id.

[12] IRS Data Book, 2023, Table 17, Examination Coverage and Recommended Additional Tax After Examination, by Type and Size of Return, Tax Years 2013–2021.

The second item in the package is proposed regulations[13] that would flag certain partnership transactions involving related parties for closer scrutiny by identifying them as transactions of interest, a type of reportable transaction. The transactions being identified in the proposed regulations include certain transactions involving partnership interests held by grantor trusts.

The last item in the package is Rev. Rul. 2024-14, in which the IRS ruled that certain related-party partnership transactions involving basis shifting, where the goal is simply to shift tax burdens rather than achieve a genuine economic purpose, lack economic substance under Sec. 7701(o).

This guidance comes after Rev. Rul. 2023-2. In that ruling, the IRS clarified that where a taxpayer creates an irrevocable trust, retaining a power that causes the taxpayer to be the owner of the entire trust for income tax purposes, but does not cause the trust assets to be included in the taxpayer's gross estate and funds the trust with assets in a transaction that is a completed gift for gift tax purposes, the bases of the assets are not stepped up to fair market value (FMV) under Sec. 1014 at the taxpayer's death because the assets were not acquired or passed from a decedent (as defined in Sec. 1014(b)). While the ruling itself was not surprising, it fueled concerns about potential future restrictions on grantor trusts.[14]

When advising clients on grantor trusts or related-party basis-shifting techniques, advisers should be sure to discuss the possibility of future regulatory changes that could reduce their effectiveness.

Landmark transferee liability decision: Estate of Paulson

A case appealed to the Ninth Circuit, Paulson,[15] centered on determining who would ultimately be personally liable for unpaid federal estate taxes. The IRS had pursued collection efforts against various parties, including the decedent's surviving spouse, beneficiaries, trustees, and the executor of the decedent's estate.

The Ninth Circuit held that Sec. 6324(a)(2) imposes personal liability for unpaid estate taxes on the categories of persons listed in the statute (generally, recipients of nonprobate property) who receive property included in the gross estate or have possession of such property on the date of death. The court also held that the defendant successor trustees and trust beneficiaries in the case were within the categories of persons listed in Sec.

[13] REG-124593-23, 89 Fed. Reg. 51476.

[14] See Ransome, "Recent Developments in Estate Planning: Part 1," 54-10 The Tax Adviser 26 (October 2023), and Carlson, "Rev. Rul. 2023-2's Impact on Estate Plans," 54-11 The Tax Adviser 8 (November 2023).

[15] Paulson, 68 F.4th 528 (9th Cir. 2023).

6324(a) and were personally liable for unpaid estate taxes, a holding that extended transferee liability further than in prior cases.

The majority opinion included a lengthy explanation to justify the court's conclusion and was followed by a strongly worded dissent. Prior to this decision, courts historically had concluded that the statute applied only to persons in actual possession of assets on the date of death or those with an immediate right to such assets (for example, the beneficiary of a life insurance policy), and not those who took possession at some time in the future. This interpretation was rejected by the Ninth Circuit, and although the decision was appealed to the U.S. Supreme Court, certiorari was denied in March 2024.[16]

This case highlights the extent of potential personal liability for those serving in fiduciary roles, as well as those who inherit assets, when unpaid claims to the U.S. government have not been prioritized. Planners should strongly advise their clients of these potential liabilities when accepting a fiduciary role and encourage waiting for an IRS closing letter before distributing estate assets.

Life insurance valuation issues: DeMatteo

DeMatteo,[17] a stipulated decision in Tax Court in early 2024, settled a dispute involving the determination of the proper valuation of a life insurance policy for gift tax purposes. Previously in the case, the Tax Court had denied the taxpayer's request for partial summary judgment on the question of whether the interpolated terminal reserve (ITR) value was required to be used for gift tax reporting purposes.[18] The taxpayer argued that the IRS regulation governing the valuation of transfers of life insurance does not require that the determination be based on the ITR.[19] The Service disagreed with this interpretation and argued it is mandatory for the value to be determined using the ITR, referring to it as "the universal method" for valuing similar life insurance policies.

Life insurance products have grown in complexity over the years, and some practitioners are finding that the ITR may not always reflect FMV. The settlement likely considered both the IRS's valuation and the taxpayer's valuation to reach a mutually agreeable compromise. The main takeaway of this case is that planners should be cautious when clients transfer existing life insurance policies and believe the gift tax value should not be based on the ITR.

[16] Paulson, No. 23-436 (U.S. 3/4/24) (cert. denied).
[17] DeMatteo, No. 3634-21 (T.C. 2/22/24) (stipulated decision).
[18] DeMatteo, No. 3634-21 (T.C. 7/21/22) (order denying summary judgment).
[19] Regs. Sec. 25.2512-6(a).

Life insurance and redemption agreements: Connelly

In Connelly,[20] an estate tax case, the Supreme Court affirmed an Eighth Circuit decision involving a company's obligation to redeem a deceased owner's shares. Two brothers, Michael and Thomas Connelly, who jointly owned a building supply corporation, Crown, entered into an agreement that upon either brother's death, the corporation would be required to redeem (i.e., purchase) the decedent brother's shares under certain circumstances. To ensure that the corporation would have enough money to redeem the decedent brother's shares if it was required, the corporation obtained $3.5 million in life insurance on each brother.

After Michael died in 2013, Crown received the life insurance proceeds from its policy on him. On the estate tax return filed for Michael's estate for 2014, the value of the proceeds from the life insurance policy were offset by the corresponding redemption obligation, therefore reducing the estate tax value of Michael's shares in the corporation.

The Eighth Circuit held that the proceeds from the life insurance policy used to fund the redemption obligation should be included for purposes of determining the estate tax value of Michael's shares without a reduction for the redemption obligation. The holding by the Eighth Circuit was inconsistent with the holding of the Eleventh Circuit in Estate of Blount.[21] In Blount, the Eleventh Circuit held that life insurance proceeds were offset by the contractual obligation to fund a redemption obligation for purposes of determining a company's value for estate tax purposes. The split between the circuits led the Supreme Court to grant certiorari in Connelly in December 2023, and in June 2024 Justice Clarence Thomas delivered the Court's unanimous opinion.

The Court affirmed the Eighth Circuit's decision, holding that a corporation's contractual obligation to redeem shares did not offset the value of life insurance proceeds committed to funding the redemption.

The Court reasoned that the estate would not have sold to a hypothetical nonfamily buyer for the amount reported on the estate tax return. It further reasoned that the company's requirement to purchase the shares had no effect on any shareholder's economic interest. The Court also took issue with the fact that the estate's argument assumed the company had the same FMV before and after the redemption, even though it had received $3.5 million of life insurance proceeds.

[20] Connelly, No. 23-146 (U.S. 6/6/24).

[21] Estate of Blount, 428 F.3d 1338 (11th Cir. 2005).

Following the Connelly decision, advisers should carefully review redemption buy-sell agreements with their clients and consider alternative structures in order to avoid a similar result.

Buy-sell agreement special valuation rules: Huffman

Sec. 2703 describes certain rights and restrictions that are disregarded when valuing property. Sec. 2703(a)(1) provides that the value of any property must be determined without regard to "any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right)." Sec. 2703(a)(2) includes any restriction on the right to sell or use such property. Sec. 2703(b) provides an exception to Sec. 2703(a) for any option, agreement, right, or restriction if (1) it is a bona fide business arrangement; (2) it is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (3) its terms are comparable to similar arrangements entered into by persons in an arm's-length transaction.

In Huffman,[22] the Tax Court considered whether a buy-sell agreement to purchase shares in a family-owned aerospace company between a son and his parents' trust and his mother's S corporation should be taken into account in determining the value of the company shares the son bought. The court determined that the agreement's terms were not comparable to similar arrangements entered into by persons in arm's-length transactions. Thus, the agreement did not meet the third requirement of Sec. 2703(b), and it was disregarded in determining the value of the shares in the company.

Disregarding the agreement, the court determined that the value of the shares was much higher than the amount the son paid for them and that the difference between their value and the amount paid was a deemed gift from his parents subject to gift tax. This case underscores the importance of ensuring that buy-sell agreements meet the specific requirements of Sec. 2703 to avoid unfavorable tax consequences.

Potential gift tax implications after trust modification allowing for reimbursement of taxes paid by grantor: CCA 202352018

Chief Counsel Advice (CCA) 202352018

In Chief Counsel Advice (CCA) 202352018, the IRS concluded that modifying a grantor trust to add a tax reimbursement clause constituted a taxable gift by the consenting trust beneficiaries to the grantor, because the addition of a discretionary power to distribute income and principal to the grantor was a relinquishment of a portion of the beneficiaries' interest in the trust.

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[22] Huffman, T.C. Memo. 2024-12.

This new position contradicts a previous IRS letter ruling from 2016 that allowed such modifications without triggering gift tax.[23] The IRS acknowledged this inconsistency and clarified in the CCA that the letter ruling no longer reflects its official position. The CCA offers limited guidance on valuing the deemed gift, suggesting that the value could be equal to the entire value of the trust, which could have significant tax implications.

Advisers should exercise caution when advising clients on trust modifications involving beneficiary consent or lack of objection.[24]

Termination of QTIP trust did not trigger deemed gift: Estate of Anenberg

On May 20, 2024, the Tax Court issued a significant opinion in Estate of Anenberg,[25] determining that the termination of a qualified terminable interest property (QTIP) trust by the surviving spouse and distribution of its assets to her did not trigger a gift tax liability for her estate under Sec. 2501.

The Tax Court held that, even if there was a transfer of property under Sec. 2519, the estate was not liable for gift tax because the surviving spouse received back the interests in property that she was treated as holding and transferring under Secs. 2056(b)(7)(A) and 2519 and made no gratuitous transfer, as required by Sec. 2501. The court's holding contrasts sharply with the IRS's stance in CCA 202118008, in which it advised that the termination of a QTIP trust where assets were distributed to the surviving spouse would result in estate inclusion and separate gift transfers, including by the spouse under Sec. 2519 and by the remainder beneficiaries under Sec. 2511, which do not offset each other.

The IRS's position in Anenberg focused on whether the surviving spouse made a gift and did not address whether the remainder beneficiaries' consent to the termination constituted a gift. This omission may come as a surprise to some when compared to the conclusions the IRS reached in a different context in CCA 202352018 (described above), which determined that modifying a grantor trust to add a tax reimbursement clause constituted a taxable gift by the consenting trust beneficiaries. In Anenberg, the IRS made no similar argument, although the court acknowledged in a footnote that it was not expressing a view on whether the remainder beneficiaries could be treated as making a gift to the surviving spouse.

The Anenberg decision clarifies that properly documented and structured sales of assets from QTIP marital trusts may not trigger gift tax liabilities, so long as no gratuitous transfers occur. However, the decision could be appealed, and the upcoming McDougall case[26] will

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[23] IRS Letter Ruling 201647001.

[24] See also McGrenera, Hinson, and Cain, "Recent CCA Raises Concerns for Irrevocable Grantor Trust Modifications," 55-6 The Tax Adviser 44 (June 2024).

[25] Estate of Anenberg, 162 T.C. No. 9 (2024).

[26] McDougall, Nos. 2458-22, 2459-22, and 2460-22 (T.C. 2/18/22) (petitions filed).

further analyze QTIP trust terminations. Advisers should closely monitor these cases and exercise caution when planning with QTIP trusts.

Charitable planning: Hoensheid

In Estate of Hoensheid,[27] the Tax Court decided whether the anticipatory-assignment-of-income doctrine applied to a taxpayer's donation of stock in his closely held corporation to a donor advised fund. Under the doctrine, a donor is deemed to have effectively realized income and then assigned it to another when the donor has a fixed right to the unpaid income. In general, where there is a contribution of appreciated stock followed by a sale of stock by the donee, a donor's right to the income from the sale is fixed if the sale is virtually certain to occur at the time of the gift.

In Hoensheid, the taxpayer donated stock in his closely held corporation to a donor-advised fund but waited until two days before the sale to transfer stock to the fund. The Tax Court found that delaying the transfer until that time made the sale a virtual certainty at the time the stock was donated. Therefore, the anticipatory-assignment-of-income doctrine applied, and the taxpayer recognized gain on the sale of the donated stock.

The donor ignored the advice of legal counsel that the transfer of shares to the donor-advised fund should occur well before the sale agreement was in place. Correspondence between the donor and his advisers reflected an intent to only transfer shares to avoid gain recognition and no desire to transfer shares if the sale would not occur. The court held that the transfer was a gift to charity, and, although the gift was an assignment of income, the taxpayer was potentially entitled to a charitable contribution deduction. However, the court further held that the taxpayer failed to comply with the charitable contribution substantiation requirements by not obtaining and attaching a qualified appraisal, so the taxpayer's charitable contribution deduction was denied.

As this case demonstrates, practitioners should be mindful of the anticipatory-assignment-of-income doctrine and charitable substantiation requirements when advising clients regarding donations of property to charitable organizations.

Bona fide debt vs. gift: Estate of Bolles

The recent case of Estate of Bolles[28] highlights key factors in determining whether advances to family members are loans or taxable gifts. In this case, a mother advanced funds to her son from 1985 to 2007 to keep his architectural practice afloat. The Tax Court determined the character of the advances using the traditional factors used to decide whether an advance is a loan or a gift. These factors include the repayments made,

[27] Estate of Hoensheid, T.C. Memo. 2023-34.
[28] Estate of Bolles, No. 22-70192 (9th Cir. 4/1/24), aff'g T.C. Memo. 2020-71.

expectations of repayment, and the borrower's ability to repay. The Tax Court held that the advances from 1985 to 1989 were loans, but the advances from 1990 through 2007 were gifts.

The Ninth Circuit affirmed the Tax Court. It found that the Tax Court reasonably determined that the advances made from 1985 to 1989 were loans because the mother had a real expectation that her son would repay the advances. However, the Ninth Circuit found that after 1989, the facts indicated that the circumstances surrounding the advances had changed. During those years, the son made no repayments of the advances and signed an agreement acknowledging he had "neither the assets nor the earning capacity" to make repayments. Further, in late 1989, the mother excluded the son from receiving assets from her personal trust at her death. Thus, the Tax Court had reasonably concluded that there was not a bona fide creditor-debtor relationship between the mother and the son for the period of 1990–2007, so the advances during this period were gifts.

This case serves as a reminder for families with outstanding intrafamily loans to carefully document the terms of the loans, ensure they are commercially reasonable, and enforce the terms of the loan agreement.

Pennsylvania Directed Trust Act

This fall, Pennsylvania's new Directed Trust Act (Act 64 of 2024) went into effect and modernized the administration of trusts in Pennsylvania. The Directed Trust Act created three new fiduciaries positions for trusts in Pennsylvania: a trust director, a trust protector, and a trust director for investments. By creating these new fiduciary positions, settlors now have more flexibility to structure and assign fiduciary responsibilities within a trust beyond the traditional trustee role.

As defined by the Directed Trust Act, a "directed trust" is a trust in which the terms of a trust grant a power of direction. A power of direction is a power granted to a person under the trust which is exercisable while the person is not serving as a trustee, is a power over the investment, management, or distribution of trust property or other matters of trust administration, including the power to modify the terms of a trust, and includes an incidental power that is appropriate and necessary to the exercise or nonexercise of a power of direction.

Trust Directors

A trust director is a non trustee who is granted a power of direction over a trust. A trust director may have the ability to direct trust investments, manage trust assets, determine distributions to beneficiaries, and in some cases, modify the terms of a trust. A settlor could chose to divide each of the roles of a trust director among multiple individuals,

combine the roles into a single trust director, or grant a single role to a single trust director. The ability to separate responsibilities can be particularly helpful if a settlor wants a specific person to manage a discrete function within a trust. A settlor or a beneficiary could serve as a trust director, but one should be cautious in utilizing the settlor or beneficiary in such a role to avoid potential estate tax inclusion or maintain creditor protection.

Trust Protectors

A trust protector is a specific type of trust director who has the authority to modify the terms of a trust. The trust protector may also be granted specific powers under the terms of a trust. For example, the Directed Trust Act outlines 12 specific powers that may be granted to a trust protector: the power to increase, decrease or modify what is distributable to the beneficiaries of a trust; to terminate a trust and direct how the trustee should distribute trust property, to expand, modify, limit, or terminate a power of appointment or grant a power of appointment to a trust beneficiary; to adjust between income and principal or convert a trust to a unitrust; to convert a trust to a special needs trust; to appoint or remove trustees, investment advisors, investment managers, and prescribe a plan of succession; to appoint or remove trust directors, specify their powers, and modify the powers of trust directors; to appoint successor trust protectors and prescribe a plan of succession; to renounce, release, limit, or modify any power given to a trustee; to resolve disagreements among trustees; to change the trust's situs or governing law or both; and to apply to a court of competent jurisdiction to interpret the terms of a trust. In addition, the settlor may expressly authorize the trust protector to take additional actions under the terms of a trust, however the trust protector may not exercise a power in a manner that would personally benefit the trust protector or vest in the trust protect a taxable power of appointment.

Unless the terms of the trust otherwise provide, the trust protector must notify the qualified beneficiaries of the trust in writing of the trust protector's exercise of power with respect to the trust. Thus, the trust could conceivably authorize the trust protector to take actions without first notifying the qualified beneficiaries of the trust. Requiring notice, however, is a good way to ensure that a trust protector's actions do not go unchecked.

As illustrated above, a trust protector's powers are vast and can be further expanded or refined if a settlor decides additional powers are required to carry out the purpose of the trust. One of the potentially most useful powers that Trust Protectors have relate to their ability to modify trust provisions, such as the ability to modify powers of appointments and distribution standards. The ability to modify the terms of the trust can be particularly useful when circumstances have changed and there might be a need to change the terms of a trust due to issues arising among the beneficiaries. For example, if a beneficiary is having drug issues or is unable to manage his or her funds and the trust requires all of the income to be distributed to the beneficiary, it may be beneficial for the Trust Protector to remove

this mandatory distribution. Or, a trust might grant a beneficiary a limited power of appointment over the trust, but due to changes in the tax law or the beneficiary not having any children, it might be in the beneficiary's best interest if the Trust Protector expands the power of appointment.

Trust Directors for Investments

The act also creates a trust director for investments. A trust director for investments has the power to direct the trustee or veto the trustee's investment recommendations and voting proxies. The trust director for investments may also select, change, or determine reasonable compensation for the investment advisers or managers, determine the frequency and methodology for valuing trust assets. Finally, the trust director for investments may exercise or veto any other investment power of the trustee or perform any other acts relating to the investments of the trust's assets.

The trust director for investments can be especially useful in situations where the beneficiaries desire that the trust invest in certain assets, such as a closely held business interest, but the trustee does not want the liability of holding a large concentration of a single asset. By creating this new fiduciary position, the settlor may grant the trust director for investments the power to direct the trustee to invest in the closely held business interest so that the trustee is relieved of liability for the investment decisions within the trust.

Duties and Liabilities of Trust Directors

It is important to note that a trust director has the same fiduciary duties and liabilities in the exercise or non exercise of a power that a trustee in a similar position would otherwise have. Thus, if a trust director for investments made a negligent investment decision, the trust director for investments would be liable for such a negligent decision. If the trust director for investments made an investment decision based on his or her own self-dealing or personal interests, such decision would be a breach of his or her fiduciary duty.

A directed trustee, however, is not responsible for the actions of a trust director, even if the directed trustee acts pursuant to the direction of the trust director. A directed trustee is not even required to monitor the actions of the trust directors or inform the settlor, beneficiaries, co-trustees, or other trust directors as to any matter in which the directed trustee did not act but a trust director did act. However, a directed trustee shall not comply with a trust director's exercise or non- exercise of a power of direction if such direction would cause the directed trustee to engage in willful misconduct. Thus, the directed trustee may not blindly follow the directions of the trust director without fear of liability.

Should My Trust Have a Trust Director?

With the enactment of the Directed Trust Act, individuals and their advisers should be considering whether it is useful or necessary to modify existing trusts to insert trust directors or draft new trusts to include trust directors. The use of trust directors is not a one-size-fits-all solution for trusts. There will be situations where the presence of a trust director, trust protector, or trust director for investments will be very useful and create flexibility for a trust. On the other hand, the added complexity of a trust director may be unnecessary in certain trusts. Ultimately, the fiduciary roles created by the Directed Trust Act give practitioners a great tool for creating flexibility in new and existing trusts.