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2023 Year-End Estate Planning Advisory

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Overview

We have certainly had our share of turbulent waters in the estate planning world from 2020-2022. With two significant elections, it is hard to remember a previous time with such substantial uncertainty about how tax planning and estate planning would evolve. That uncertainty required estate planners and their clients to be especially nimble, creative to a degree not seen before (more on that in a moment), and ready to act. Some clients indeed acted, while others waited to see how the tides might turn.

2023 told a different story. For the first time in a few years, there was less uncertainty with respect to changing laws — in large part because the Democrats control the Senate while the Republicans control the House, and

2023 was not an election year. The political arena was well-established, and the split in legislative control meant that large substantive changes were unlikely.

Nevertheless, 2023 was far from quiet. While the waters were calm, quiet water enabled quicker movement. In just over two years, current tax exemption limits are set to be cut in half. Many of our clients used the relative calm of 2023 to implement (or supplement) the same creative planning objectives that were born from the 2020- 2022 uncertainty. Indeed, if 2020-2022 taught us anything, it was that well-thought-out estate planning can have tremendously positive effects on families. And sometimes, the best ideas develop when the time crunch is real.

Yet, looking ahead, we see storm clouds building that have the potential to bring about vast change. A significant election is less than a year away. As the inflation-adjusted exemption threshold continues to climb, it illustrates just how advantageous it is to fully maximize lifetime gifting strategies while we are certain we still can. And who knows if some of the tried and true estate planning strategies will be around forever. Sticking with our stormy waters metaphor, we can sum up 2023 as time used to batten down the hatches because we expect 2024 and 2025 will bring the return of the turbulence from our recent past.

What follows is our review of developments and guidance on how to best prepare.

Inflation-Adjusted Tax Figures

The Tax Cuts and Jobs Act (the TCJA), which was signed into law on

December 22, 2017, and most of which became effective on January 1, 2018, has proven to have many implications for domestic corporate and individual income tax, as well as federal gift, estate and generation-skipping transfer (GST) tax, fiduciary income tax and international tax. Since the TCJA's enactment, various technical corrections have been issued, as has the Internal Revenue Service's (IRS) guidance on certain aspects of the new tax regime. In light of the TCJA and recent IRS guidance, it is important to review existing estate plans consider future planning to take advantage of the increased exemption amounts (which – ***importantly*** – are presently set to sunset on January 1, 2026, at which time, absent legislative action, the prior exemption amounts (indexed for inflation, using the chained CPI figure) will be returned to), and maintain flexibility to allow for future strategic planning. In prior editions of our Year-End Estate Planning Advisories, we included detailed discussions of the TCJA and its important estate planning components. If you wish to review a more thorough analysis of the TCJA and other recent legislation like the Build Back Better Act and the Inflation Reduction Act, please see our most recent advisories for 2022 and 2021.

Federal Estate, GST and Gift Tax Rates

The federal estate, gift and GST applicable exemption amounts are as summarized below. In simple terms, these dollar figures represent the amount of wealth that each individual can transfer during their lifetime and/or at death (in the aggregate) before incurring any federal transfer taxes (which currently are assessed at a rate of 40 percent):

2023	2024
$12,920,000	$13,610,000 *(an increase of $690,000)*

The federal estate tax exemption that applies to non-resident aliens was not increased under the TCJA. Under current law, the exemption for non-resident aliens remains at $60,000 (absent the application of an estate tax treaty).

Annual Gift Tax Exclusions

Each year, individuals are entitled to make gifts to each donee using the “Annual Exclusion Amount” without incurring gift tax or using any of their applicable exemption amount against estate and gift taxes. The Annual Exclusion Amount is as follows:

2023	2024
$17,000	$18,000 *(an increase of $1,000)*

Thus, in 2023, a married couple together can gift $34,000 to each donee without gift tax consequences (*consider doing so before the end of the year if you have not done so yet!*). In 2024, they will be able to gift $36,000 together (*consider doing so early in the year to remove as much income from and appreciation to the gifted property as possible*). To make gifts together, spouses can agree to split the gift by consenting to gift splitting on a timely filed gift tax return.

For those with noncitizen spouses, please note that the limitation on tax-free annual gifts made to noncitizen spouses will increase from $175,000 in 2023 to $185,000 in 2024.

Federal Income Tax Rates

There are presently seven individual income tax brackets, with a maximum rate of 37 percent. The 37 percent tax rate will affect single taxpayers whose income exceeds $578,125 in 2023 ($609,350 in 2024) and married taxpayers filing jointly whose income exceeds $693,750 in 2023 ($731,200 in 2024).

The threshold for the imposition of the 3.80 percent surtax on net investment income and the 0.90 percent Medicare surtax on earned income is $200,000 for single taxpayers, $250,000 for married taxpayers filing jointly, and $14,450 for trusts and estates in both 2023 and 2024 (except that the trusts and estates threshold will increase to $15,200 in 2024).

Estates and trusts will reach the maximum rate with taxable income of more than $14,450 in 2023 ($15,200 in 2024).

Expatriation Related Increases

Someone who expatriates will be considered a “covered expatriate” (among other tests that are not inflation adjusted) if he or she has an average annual net income tax, for the five-year period preceding the expatriation date, that is greater than $201,000 in 2024 (up from $190,000 in 2023).

The exclusion amount from net unrealized gain in a covered expatriate's property, which will be subject to an exit tax as if the covered expatriate had sold his or her worldwide property for fair market value on the day before terminating his or her residency, is $866,000 in 2024 (up from $821,000 in 2023).

Corporate Transparency Act Reporting Begins January 1, 2024

The Corporate Transparency Act (CTA) comes into effect January 1, 2024, and requires a "Reporting Company" (described below) to disclose specific information regarding itself, its "Beneficial Owners" (described below), and its "Company Applicants" (described below) to the US Treasury Department's Financial Crimes Enforcement Network (FinCEN). The underlying purpose of the CTA is to curb illicit activity by non-transparent entities.

It is critical to recognize that reporting requirements for millions of Reporting Companies begin just a few weeks from the publication of this advisory. In general, a "Reporting Company" means a domestic or foreign corporation, limited liability company, or other similar entity that registers with a United States State or Tribal Office and is not otherwise exempt from the CTA's reporting requirements. Based upon the foregoing registration requirement, trusts do not meet the definition of a Reporting Company. There are currently 23 limited exceptions. Nevertheless, the scope of the CTA is quite extensive.

A Reporting Company is required promptly to submit to FinCEN reports regarding (i) the Reporting Company, (ii) its Beneficial Owners (i.e. individuals that have substantial control over a Reporting Company and/or

individuals that directly or indirectly own or control at least 25 percent, in the aggregate, of the total "ownership interests" (which is broadly construed) of a Reporting Company), and (iii) its Company Applicants (i.e. individuals who file the required registration and individuals who are primarily responsible for directing or controlling such filing). A comprehensive overview of the CTA detailing Reporting Companies, Beneficial Owners, Company Applicants, and Beneficial Ownership Information can be found here.

As mentioned above, there are limited, specific exemptions from the definition of a Reporting Company. A full list of those 23 exemptions is contained in the link referenced immediately above. Notably, Family Offices are not specifically exempted from the definition of a Reporting Company. However, the following exemptions from the definition of a Reporting Company may be pertinent in the Family Office/Private Wealth arena:

> Large Operating Company: Taxable entities that (a) employ more than 20 employees on a full-time basis in the United States, (b) filed in the previous year federal income tax or information returns in the United States demonstrating more than $5,000,000 in gross receipts or sales in the aggregate (on a consolidated basis, if applicable), and (c) have an operating presence at a physical office within the United States.
> Banks: A registered bank as defined in Section 3 of the Federal Deposit Insurance Act, Section 2(a) of the Investment Company Act of 1940, or Section 202(a) of the Investment Advisers Act of 1940 (e.g., certain private trust companies).
> Investment Advisor: Registered investment advisors under the Investment Adviser Act of 1940 (e.g., certain multi-family offices).
> Tax-Empty Entity: Organizations described in Section 501(c) of the Internal Revenue Code of 1986 (Code) (e.g., a private foundation).
> Subsidiary: Any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by an exempt entity (other than money services business, pooled investment vehicles, or entities assisting a tax-exempt entity). Note that this exemption is interpreted

narrowly and does not include parent companies, holding companies, or other affiliates of exempt entities.

Inactive Entities: Entities formed before January 1, 2020, that (a) are not engaged in an active business, (b) are not owned by a foreign person, (c) have not experienced a change in ownership in the preceding 12-month period, (d) have not sent or received funds in an amount greater than $1,000 in the preceding 12-month period, and (e) do not otherwise hold any assets.

While trusts are not independently considered Reporting Companies, these types of trusts can be Beneficial Owners of Reporting Companies — either under the substantial control test or the ownership test described above. For those trusts that qualify as a *Beneficial Owner* of a Reporting Company, the analysis regarding reportable individuals "looks through" to the following specific individuals:

A beneficiary, if such beneficiary (a) is the sole permissible recipient of income and principal or (b) has the right to demand distributions or withdraw substantially all trust assets.

A trust's grantor, if such grantor has the right to revoke the trust or otherwise withdraw the assets of the trust.

Trustees or other individual(s) with the authority to control or dispose of trust assets.

Despite numerous comments requesting clarification, the CTA's final regulations (as of the publication of this advisory) do not provide clarity with respect to what specific individuals fall into the category of "other individuals who can dispose of trust assets" (e.g., Trust Protectors, Business Advisors, Distribution Committees, or Investment Advisors). ***Thus, a key takeaway with respect to identifying which individuals are reportable when trusts are Beneficial Owners of a Reporting Company is that the specific terms of the trust need to be closely examined and analyzed.***

Reporting Companies are required to report the following information about themselves to FinCEN: (a) full legal name, (b) any trade name or d/b/a, (c) their principal place of business (or, in the case of a foreign Reporting Company, its primary location in the United States), (d) the State, tribal, or foreign jurisdiction of formation (and in the case of a foreign Reporting Company, the State or tribal jurisdiction where it fire registers), and (e) a unique taxpayer ID number. Moreover, Reporting Companies are required to report the following information about their Beneficial Owners and Company Applicants to FinCEN: (v) full legal name of such individual, (w) date of birth of such individual, (x) the current address of such individual, (y) a unique ID number for such individual such as an unexpired passport number or driver's license, and (z) an image of the document from which such unique ID number was obtained. Any changes to such information must be promptly reported to FinCEN. Ultimately, the burden to report such information (collectively, "Beneficial Ownership Information") lies with the Reporting Company.

The timeline for reporting Beneficial Ownership Information for a Reporting Company varies based on the company's formation date. Note that in late September 2023, FinCEN proposed an amendment to its reporting rule to provide that, solely with respect to entities formed or registered during calendar year 2024, such entity will have 90 days to submit its initial report to FinCEN. As of the publication of this advisory, such amendment has not been finalized. Assuming such amendment is finalized prior to January 1, 2024:

> For Reporting Companies formed before January 1, 2024: all Beneficial Ownership Information is required to be submitted to FinCEN not later than January 1, 2025.
> For Reporting Companies formed on or after January 1, 2024, but

before January 1, 2025: all Beneficial Ownership Information is required to be submitted to FinCEN within 90 calendar days of formation.
For entities formed on or after January 1, 2025: all Beneficial Ownership Information is required to be submitted to FinCEN within 30 calendar days of formation.

Note that updates to Beneficial Ownership Information (e.g., the replacement of a manager or director, a new address for a Beneficial Owner, or a sale or gift which shifts at least 25 percent of the ownership of a Reporting Company to a new individual/entity) are due within 30 calendar days of the change.

The determination of what entities are reportable under the CTA, which individuals are deemed Beneficial Owners, and what information must be reported is a fact-specific inquiry that involves an active review of the CTA, the applicable company structure, and the managers, directors, owners, and more for all such entities. This case-by-case determination becomes increasingly more complex with respect to identifying the reportable individuals in cases where a trust qualifies as a Beneficial Owner with respect to a Reporting Company. Depending on the company structure, as well as the applicable terms of any relevant trusts, this may require substantial resources to analyze correctly and adequately.

Important Planning Considerations for 2023 and 2024

Given the changes implemented by the TCJA, taxpayers should review their existing estate plans and consult with their tax advisors about how to best take advantage of, where appropriate, the higher exemption amounts while they are, in all events, available. The following is a summary of several items to consider.

Year-End Checklist for 2023

Before going into greater detail on available strategies, here is a short checklist of estate planning strategies that can be easily implemented before year-end:

- Make year-end annual exclusion gifts of $17,000 ($34,000 for married couples).
- Make year-end IRA contributions.
- Create 529 Plan accounts before year-end for children and grandchildren and consider front-loading the accounts with five years' worth of annual exclusion gifts, taking into account the aggregate of any gifts made during the year to children and grandchildren.
- Pay tuition and non-reimbursable medical expenses directly to the school or medical provider.
- Consider making charitable gifts (including charitable IRA rollovers of up to $100,000, in certain circumstances) before year-end to use the deduction on your 2023 income tax return.

Review Formula Bequests

Many estate plans use "formula clauses" that divide assets upon the death of the first spouse between a "credit shelter trust," which utilizes the client's remaining federal estate tax exemption amount, and a "marital trust," which qualifies for the federal estate tax marital deduction and postpones the payment of federal estate taxes on the assets held in the marital trust until the death of the surviving spouse. While the surviving spouse is the only permissible beneficiary of the marital trust, the credit shelter trust may have a different class of beneficiaries, such as children from a prior marriage. With the TCJA's increase in the exemption amounts, an existing formula clause could potentially fund the credit shelter trust with up to the full federal exemption amount of $12,920,000 in 2023 and

$13,610,000 in 2024. This formula could potentially result in a smaller bequest to the marital trust for the benefit of the surviving spouse than was intended or even no bequest for the surviving spouse at all. There are many other examples of plans that leave the exemption amount and the balance of the assets to different beneficiaries. Depending on the class of beneficiaries of the credit shelter trust, if the taxpayer lives in a state where the federal and state exemption amounts are decoupled or not aligned, the taxpayer's estate may inadvertently find itself subject to estate tax at the state level. Taxpayers should review any existing formula clauses in their current estate plans to ensure they are still appropriate given the increase in the federal exemption amounts and the implications of the potential sunset of these exemption amounts. In addition, taxpayers should consider alternative drafting strategies, such as disclaimers, to maintain flexibility in their plans.

Income Tax Basis Planning

Taxpayers should consider the potential tradeoffs of using the increased exemption amounts during their lifetimes to gift assets to others, as opposed to retaining appreciated assets until their death so that those assets receive a stepped-up income tax basis. Taxpayers may want to consider retaining low-basis assets, which would then be included in their taxable estates and receive a step-up in income tax basis, while prioritizing high-income tax basis assets for potential lifetime gift transactions. In addition, if a trust beneficiary has unused federal estate tax exemption, consideration should be given to strategies that would lead to low-income tax basis assets currently held in trust, and otherwise not includible in a beneficiary's taxable estate, being included in the beneficiary's taxable estate, such as:

granting the beneficiary a general power of appointment over the trust assets;
using the trust's distribution provisions to distribute assets directly to the beneficiary so that the assets may obtain a step-up in basis upon the death of the beneficiary to whom it was distributed; or
converting a beneficiary's limited power of appointment into a general power of appointment by a technique commonly known as "tripping the Delaware tax trap."

Consequently, the assets included in the beneficiary's estate would receive a step up in income tax basis at the beneficiary's death and would take advantage of the beneficiary's unused federal estate tax exemption amount. Whether these techniques should be implemented depends on a careful analysis of the basis of the assets held in trust and the beneficiary's assets and applicable exemption amounts and should be discussed with advisors.

529 Plan Changes

The TCJA expanded the benefits of 529 Plans for federal income tax purposes. Historically, withdrawals from 529 Plans have been free from federal income tax if the funds were used toward qualified higher education expenses. Under the TCJA, qualified withdrawals of up to $10,000 can now also be made from 529 Plans for tuition in K-12 schools. As a result, the owner of the 529 Plan can withdraw up to $10,000 per beneficiary each year to use towards K-12 education. The earnings on these withdrawals will be exempt from federal income tax under the TCJA. However, because each state has its own specific laws addressing 529 Plan withdrawals, and not all states provide that withdrawals for K-12 tuition will be exempt from state income taxes, taxpayers should consult with their advisors to confirm the rules in their respective states. A concern with 529 plans is that leftover

funds no longer needed for educational purposes may be trapped in the account unless a penalty is paid when the account is withdrawn for a non-qualified purpose. SECURE 2.0 (discussed further below) permits a beneficiary of 529 accounts to roll over up to $35,000 over his or her lifetime from any 529 account into a Roth IRA.

Planning to Use Increased Federal Exemptions

Given that the increased federal exemption amounts are currently set to sunset at the end of 2025, it may be prudent to make use of these increased amounts before they disappear (with the caveat that the law may, of course, change prior to 2026, and as part of a deal to make other changes, the exemptions may remain where they are). While a change in the federal exemption amounts has not taken place so far under the Biden administration, it nevertheless may be prudent to make use of the increased amount in 2023 and/or 2024. We note that a change in the law can occasionally occur without much-advanced notice. Also, 2025 will be a very busy time for estate planners (and, where needed, appraisers). Accordingly, for individuals who plan to use their exemption prior to the end of 2025, we encourage you to complete that planning in 2024 to avoid the 2025 rush (plus, the sooner an individual acts, the more income from, and appreciation on, the transferred assets can accumulate outside of the taxable estate).

Gifting Techniques to Take Advantage of the Increased Applicable Exemption Amount

Taxpayers may want to consider making gifts to use the increased federal exemption amount. It is less expensive to make lifetime gifts than to make gifts at death because tax is not imposed on dollars used to pay gift tax, but

estate tax is imposed on the dollars used to pay estate tax. In addition, taxpayers may benefit by removing any income from and appreciation on the gift from their estates. However, taxpayers should seek advice if they have used all of their applicable exemption amount and would pay federal gift tax on any gifts. Making gifts that result in significant gift tax payments may not always be advisable in the current environment.

A countervailing consideration of lifetime gifting is that the gifted assets will not get a step-up in basis upon death (as would assets held at death) and will thus generate capital gains tax if they are subsequently sold for an amount higher than their basis. The IRS released Revenue Rule 2023-02, which reiterated this previously well-established trade-off. Accordingly, the decision of whether and how to embark on a lifetime gifting strategy depends on a number of factors, including the bases of the transferor's various assets, their projected income and appreciation, the total amount of the transferor's assets, and the transferor's remaining applicable exemption amount. For individuals with assets far exceeding their applicable exemption amounts, lifetime gifting of high-basis assets generally may be recommended. However, individuals with total assets close to or below their applicable exemption amounts should exercise caution before making gifts of low-basis assets. Instead, those individuals should consider holding their assets until death to achieve a step-up in basis upon death while minimizing estate taxes. Of course, maintaining a comfortable standard of living is a factor that also must be considered.

If undertaking a gifting strategy, gifts to use the increased exemption may be made to existing or newly created trusts. For instance, a taxpayer could create a trust for the benefit of the taxpayer's spouse (a spousal lifetime access trust, or a "SLAT") and gift assets to the SLAT using the taxpayer's

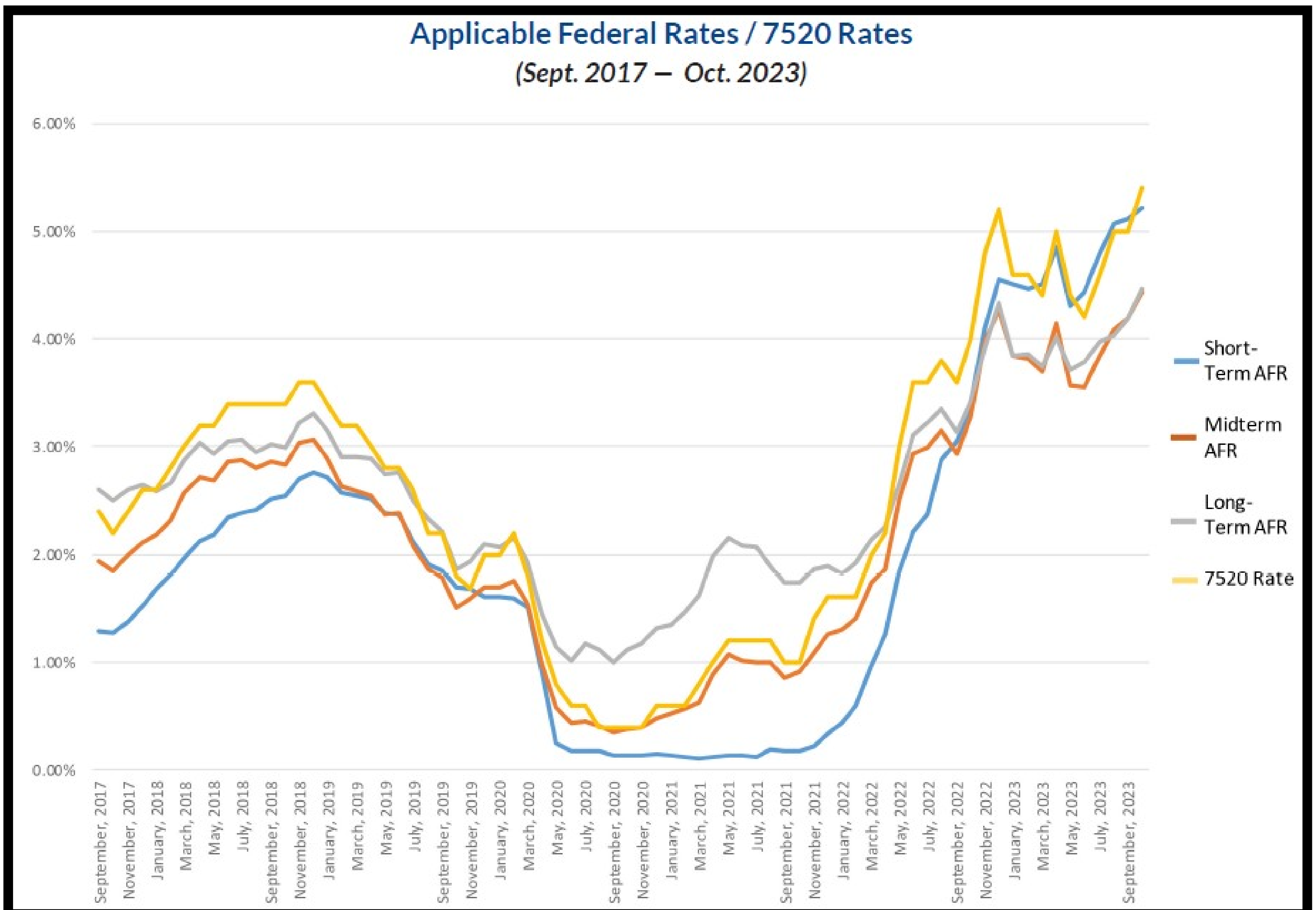
increased federal exemption amounts. The gifted assets held in the SLAT should not be includible in the taxpayer's or spouse's respective taxable estates, and distributions could be made to the spouse from the SLAT to provide the spouse with access to the gifted funds, if needed, in the future. Of course, marital stability and the health of the other spouse need to be considered. Additionally, gifts could be made by a taxpayer to dynasty trusts (to which GST exemption is allocated), which would allow the trust property to benefit future generations without the imposition of estate or GST tax.

Absent legislative reform, the federal applicable exemption amount will increase by $690,000 ($1,380,000 for a married couple) in 2024. Therefore, even if a taxpayer uses some or even all of the available applicable exemption amount before the end of 2023, additional gifts may be made in 2024 without paying any federal gift tax. Based on current law, the applicable exemption amount also will be adjusted for inflation in future years. Those residents in Connecticut should be mindful that Connecticut is the only state with a state-level gift tax; although the Connecticut state-level gift tax exemption was $9,100,000 in 2022, it matched the federal exemption level of $12,920,000 ($25,840,000 for married couples) in 2023. New York residents, on the other hand, should be mindful that, notwithstanding the fact that New York does not have a state-level gift tax, generally gifts made within three years of death are added back to the decedent's taxable estate for New York state estate tax purposes.

Other Techniques to Take Advantage of the Increased Applicable Exemption Amount

In addition to making gifts to use the increased exemption, below is a summary of several other broadly applicable recommendations:

Sales to Trusts. Taxpayers should also consider using the increased federal exemption amounts through gifts to grantor trusts followed by sale transactions to such grantor trusts for a down payment and a note for the balance. The increased federal exemption may provide a cushion against any asset valuation risk attendant with such sales. Taxpayers who enter into such sale transactions should consider taking advantage of the adequate disclosure rules to start the three-year statute of limitations running. Taxpayers should also note,however, that the Fiscal Year 2024 Greenbook (discussed below) is proposing changes to sale transactions to grantor trusts. Interest rates on promissory notes are presently at high rates but generally are still advantageous to engage in this type of transaction. For illustrative purposes, please see the below chart that shows just how dramatically interest rates have risen in the past few years.



Loan Forgiveness/Refinancing. If taxpayers are holding promissory notes from prior estate planning transactions, from loans to family

members, or otherwise, they should consider using some or all of the increased federal exemption amounts to forgive these notes. Consideration could be given to refinancing existing notes, but given the higher interest rates, that may not be advantageous at present.

Allocation of GST Exemption to GST Non-Exempt Trusts. If a taxpayer's existing estate plan uses trusts that are subject to GST tax (GST non-exempt trusts), consideration should be given to allocating some or all of the taxpayer's increased GST exemption amount to such trusts.

Balancing Spouses' Estates. For married taxpayers, if the value of the assets owned by one spouse is greater than the increased federal exemption amounts and greater than the value of the assets owned by the other spouse, consideration should be given to transferring assets to the less propertied spouse. Such a transfer would provide the less propertied spouse with more assets to take advantage of the increased federal exemption amounts, especially the increased GST exemption, which is not portable to the surviving spouse upon the first spouse's death. Taxpayers should be mindful, however, that transfers to non-US citizen spouses are not eligible for the unlimited marital deduction for federal gift tax purposes, and such transfers should stay within the annual exclusion for such gifts ($175,000 in 2023; $185,000 in 2024) to avoid federal gift tax. Additionally, creditor protection should be considered before transferring assets from joint name or from one spouse's name to the other spouse's name. Note that the annual exclusion for gifts (to donees other than a spouse) is $17,000 in 2023 and $18,000 in 2024.

Life Insurance. Taxpayers may wish to review or reevaluate their life insurance coverage and needs with their insurance advisors.

Review and Revise Your Estate Plan to Ensure it Remains Appropriate

As noted above, any provisions in wills and trust agreements that distribute assets according to tax formulas and/ or applicable exemption amounts should be reviewed to ensure that the provisions continue to accurately reflect the testator's or grantor's wishes when taking into account the

higher applicable exemption amounts. Consideration should also be given to including alternate funding formulas in wills or trust agreements that would apply if the federal estate tax exemption amounts do, in fact, sunset in 2026.

Additionally, in light of the increased exemption amounts, taxpayers should also consider whether certain prior planning is now unnecessary and should be unwound, such as certain qualified personal residence trusts (QPRTs), family limited partnerships (FLPs) and split-dollar arrangements.

Allocation of GST-applicable exemption amounts should be reviewed to ensure that it is used most effectively if one wishes to plan for grandchildren or more remote descendants. In addition, because of increased GST exemption amounts available under the TCJA, allocation of some or all of one's increased GST exemption amounts to previously established irrevocable trusts that are not fully GST exempt may be advisable.

Taxpayers should continue to be cautious when relying on portability in estate planning, as portability may not be the most beneficial strategy based on your personal situation. In addition, a deceased spouse's unused exclusion (DSUE) may not be available upon remarriage of the surviving spouse. Furthermore, since the DSUE amount is frozen upon the first spouse's death, no appreciation is allocated to the DSUE amount between the first spouse's death and the surviving spouse's subsequent death, which would limit the amount of transfer tax free assets that could pass to beneficiaries; however, when a credit shelter trust is used in lieu of portability, the appreciation on the assets funding the credit shelter trust will inure to the beneficiaries' benefits. However, portability may be a viable option for some couples with estates below the combined exemption

amounts. Portability can be used to take advantage of the first spouse to die's estate tax exemption amount, as well as obtain a stepped-up basis at each spouse's death. Portability can also be used in conjunction with a trust for the surviving spouse (a QTIP trust) in order to incorporate flexibility for post-mortem planning options. Factors such as the asset protection benefits of using a trust, the possibility of appreciation of assets after the death of the first spouse to die, the effective use of both spouses' GST exemption, and state estate tax should be discussed with advisors in determining if relying on a portability election may be advisable. For taxpayers looking to make a portability election, effective July 8, 2022, Rev. Proc. 2022-32 provides certain taxpayers with a more simplified method to make the portability election, allowing them to be able to elect portability of a DSUE up to five years after the decedent's date of death.

Unmarried couples should continue to review and revise their estate planning documents and beneficiary designations. Since the advent of same-sex marriage, it is now clear that domestic partners, even if registered as such, do not qualify for the federal (and in many cases state) tax and other benefits and default presumptions that are accorded to married couples.

Finally, in view of the potential sunset of many pertinent provisions of the TCJA, estate plans should provide for as much flexibility as possible. As noted above, formula bequests should be reviewed to ensure they are appropriate under current law, and consideration should be given to granting limited powers of appointment to trust beneficiaries to provide flexibility for post-mortem tax planning. A Trust Protector (or Trust Protector committee) may also be appointed to give a third party the ability to modify or amend a trust document based on changes in the tax laws or unforeseen

future circumstances or to grant certain powers to trust beneficiaries that may have tax advantages under a new tax regime (such as the granting of a general power of appointment to trust beneficiaries in order to obtain a stepped-up basis in trust assets at the beneficiary's death).

Mitigate Trust Income Tax and Avoid the Medicare Surtax With Trust Income Tax Planning

Non-grantor trusts should consider making income distributions to beneficiaries. Trust beneficiaries may be taxed at a lower taxed rate, especially due to the compressed income tax brackets applicable to non-grantor trusts. Additionally, a complex, non-grantor trust with undistributed annual income of more than $12,500 (adjusted for inflation) will be subject to the 3.8 percent Medicare surtax. However, some or all of the Medicare surtax may be avoided by distributing such income directly to beneficiaries who are below the individual net investment income threshold amount for the Medicare surtax ($200,000 for single taxpayers, $250,000 for married couples filing jointly and $125,000 for married individuals filing separately).

Careful evaluation of beneficiaries' circumstances and tax calculations should be made to determine whether trusts should distribute or retain their income.

Transfer Techniques

Many planning techniques used in prior years continue to be advantageous under the TCJA. Due to the potential sunsetting of many applicable provisions of the TCJA, consideration should be given to planning that minimizes the risk of paying current gift taxes but still allows taking

advantage of the increased exemptions amounts to shift assets and appreciation from the taxable estate. Additionally, consideration should be given to selling hard-to-value assets due to the increased exemption available to “shelter” any valuation adjustment of these assets upon audit. Lifetime gifting and sales transactions remain very important in providing asset protection benefits for trust beneficiaries, shifting income to beneficiaries in lower tax brackets, and providing funds for children or others whose inheritance may be delayed by the longer life expectancy of one’s ancestors.

Grantor Retained Annuity Trusts

Grantor-retained annuity trusts (GRATs) remain one of our most valuable planning tools, though given recent higher interest rates, their practicality has decreased. Under current law, GRATs may be structured without making a taxable gift. Therefore, even if one has used all of his or her applicable exemption amount, GRATs may be used without incurring any gift tax. Because GRATs may be created without a gift upon funding, they are an increasingly attractive technique for clients who want to continue planning to pass assets to their descendants without payment of gift tax in the uncertain tax environment.

A GRAT provides the grantor with a fixed annual amount (the annuity) from the trust for a term of years (which may be as short as two years). The annuity the grantor retains may be equal to 100 percent of the amount the grantor used to fund the GRAT, plus the IRS-assumed rate of return applicable to GRATs (which for transfers made in November 2023 is 5.60 percent, which is up from November 2022’s rate of 4.80 percent). As long as the GRAT assets outperform the applicable rate, at the end of the

annuity term, the grantor will be able to achieve a transfer tax-free gift of the spread between the actual growth of the assets and the IRS assumed rate of return. Although the grantor will retain the full value of the GRAT assets, if the grantor survives the annuity term, the value of the GRAT assets in excess of the grantor's retained annuity amount will then pass to whomever the grantor has named, either outright or in further trust, with no gift or estate tax.

Sales to Intentionally Defective Grantor Trusts (IDGTs)

Sales to IDGTs have become an increasingly popular planning strategy due to the increased exemption amounts under the TCJA.

In utilizing a sale to an IDGT, a taxpayer would transfer assets likely to appreciate in value to the IDGT in exchange for a commercially reasonable down payment and a promissory note from the trust for the balance. From an income tax perspective, no taxable gain would be recognized on the sale of the property to the IDGT because it is a grantor trust, which makes this essentially a sale to one's self. For the same reason, the interest payments on the note would not be taxable to the seller or deductible by the trust.

If the value of the assets grows at a greater pace than the prevailing applicable federal rate (which for sales in November 2023 is 5.30 percent for a short-term note, up from the applicable federal rate for a sale in November 2022 of 4.10 percent for a short-term note), as with a GRAT, the appreciation beyond the federal rate will pass free of gift and estate tax.

The increased federal exemption amounts may provide a cushion against any asset valuation risk attendant to such sales. Additionally, the increased

exemption amounts permit the sale of a substantially larger amount of assets to grantor trusts. Typically, grantor trusts should be funded with at least 10 percent of the value of the assets that will be sold to the trust. With the higher exemption amounts, those who have not used any of their exemptions could contribute up to $12.92 million (or $25.84 million if splitting assets with a spouse) to a grantor trust in 2023. This would permit the sale of up to $129.2 million (or $258.4 million) of assets to the trust in exchange for a promissory note with interest at the appropriate AFR.

Consider a Swap or Buy-Back of Appreciated Low Basis Assets from Grantor Trusts

If a grantor trust has been funded with low-basis assets, the grantor should consider swapping or buying back those low-basis assets in exchange for high-basis assets or cash. If the grantor sold or gave (through a GRAT or other grantor trust) an asset with a low basis, when that asset is sold, the gain will trigger capital gains tax. However, if the grantor swaps or purchases the asset back from the grantor trust for fair market value, no gain or loss is recognized. The trust would then hold cash or other assets equal to the value of the asset that was repurchased. Alternatively, many grantor trust instruments give the grantor the power to substitute the trust's assets with other assets, which would allow the low-basis assets to be removed from the trust in exchange for assets of equal value that have a higher basis. Then, on the grantor's death, the purchased or reacquired asset will be included in the grantor's taxable estate and will receive a step-up in basis equal to fair market value, eliminating the income tax cost to the beneficiaries. Those whose estates may not be subject to estate taxes due to the current high exemption amounts may utilize swaps or buy-backs to "undo" prior planning strategies that are no longer needed in today's

environment. Particular care should be taken when considering swapping hard-to-value assets. In that circumstance, an appraisal from a qualified appraiser should be obtained to support the valuation of the swapped assets. This not only helps limit fiduciary liability claims but also helps against an argument that the swap was not done for assets of equal value, which could potentially result in a gift being made by the grantor to the trust.

Consider the Use of Life Insurance

Life insurance presents significant opportunities to defer and/or avoid income taxes, as well as provide assets to pay estate tax or replace assets used to pay estate tax. Generally speaking, appreciation and/or income earned on a life insurance policy accumulates free of income taxes until the policy owner makes a withdrawal or surrenders or sells the policy. Thus, properly structured life insurance may be used as an effective tax-deferred retirement planning vehicle. Proceeds distributed upon the death of the insured are completely free of income taxes. Taxpayers should consider paying off any outstanding loans against existing policies in order to maximize the proceeds available tax- free at death, although potential gift tax consequences must be examined. Note that the decision to pay off such loans requires a comparison of the alternative investments that may be available with the assets that would be used to repay the loans and the interest rate on the loans.

Use Intra-Family Loans and Consider Re-Financing Existing Intra-Family Loans

While these techniques work better when interest rates are low, because the exemption amounts are so high, many techniques involving the use of

intra-family loans should be considered, including:

- The purchase of life insurance on the life of one family member by an irrevocable life insurance trust, with premium payments funded by loans from other family members.
- The creation of trusts by older generation members for the benefit of younger family members, to which the older generation members loan funds. The spread between the investment return earned by the trust and the interest owed will create a transfer tax-free gift.
- Forgiving loans previously made to family members. The amount that is forgiven in excess of the annual gift tax exclusion amount will be a gift and thus will use a portion of one's applicable gift tax and/or GST tax exemption amount. This may be a beneficial strategy considering the increased exemption amounts.

Installment Sale to Third-Party Settled GST Tax-Exempt Trust

Unique planning opportunities and transfer tax benefits may be available if a relative or friend of the taxpayer has an interest in creating and funding a trust for the benefit of the taxpayer and/or the taxpayer's family. For example, a third-party grantor (e.g., a relative or friend of the taxpayer) could contribute cash to a trust for the benefit of the taxpayer, allocate GST tax exemption to that gift, and then that trust could purchase assets from the taxpayer in exchange for such cash and a secured promissory note in the remaining principal amount of assets purchased. While this sale could result in payment of capital gains tax to the taxpayer (ideally at an earlier, lower value), this planning could present the following potential benefits:

- there should be no transfer tax concerns for the third-party grantor if the grantor's other assets, even when added to the value of the foregoing gift, would not be sufficient to cause the estate tax to apply at the grantor's death (this depends on what the estate tax exemption amount is at the grantor's subsequent death);
- the taxpayer could receive a step up in basis as of the date of the

initial sale;

the taxpayer could be a beneficiary, hold a limited power of appointment over and control who serves as trustee of the trust; and

the appreciation in the value of the asset being sold from the date of the initial sale above the interest rate on the promissory note (e.g., 4.69 percent is the mid-term AFR for a sale completed in November 2023) would accrue transfer-tax-free for the benefit of the taxpayer and/or the taxpayer's family; and

the trust could be structured in such a way as to provide protection from the taxpayer's creditors and remove the trust assets from the taxpayer's and his/her family members' taxable estates.

In order to achieve the foregoing benefits, it is important that only the third-party grantor makes any gratuitous transfers to the trust and that the third-party grantor not be reimbursed for any such transfers.

Consider Charitable Planning

A planning tool that is very effective in a high-interest rate environment is a Charitable Remainder Annuity Trust (CRAT), which combines philanthropy with tax planning. A CRAT is an irrevocable trust that pays an annual payment to an individual (typically the grantor) during the term of the trust, with the remainder passing to one or more named charities. The grantor may receive an income tax deduction for the value of the interest passing to charity. Because the value of the grantor's retained interest is lower when interest rates are high, the value of the interest passing to charity (and therefore the income tax deduction) is higher.

Alternatively, a strategy that works better in a low-interest rate environment is a Charitable Lead Annuity Trust (CLAT). A CLAT is an irrevocable trust that pays one or more named charities a specified annuity payment for a fixed term. At the end of the charitable term, any remaining assets in the

CLAT pass to the remainder, noncharitable beneficiaries. As with a GRAT, to the extent the assets outperform the IRS assumed rate of return, those assets can pass transfer-tax-free to the chosen beneficiaries. A CLAT may become an attractive option if interest rates fall.

Be mindful of the ability to make IRA charitable rollover gifts, which allows an individual who is age 70 1/2 or over to make a charitable rollover of up to $100,000 (adjusted for inflation, pursuant to SECURE 2.0, discussed next) to a public charity without having to treat the distribution as taxable income. Other types of charitable organizations, such as supporting organizations, donor-advised funds, or private foundations, are not eligible to receive the charitable rollover. Therefore, if a taxpayer needs to take a required minimum distribution, he or she may arrange for the distribution of up to $100,000 (adjusted for inflation) to be directly contributed to a favorite public charity and receive the income tax benefits of these rules. Due to new limitations on itemized deductions (i.e., the cap on the state and local tax deduction), some taxpayers may no longer itemize deductions on their personal income tax returns. Without itemizing deductions, these taxpayers could not receive the income tax benefit of a charitable deduction for charitable contributions.

Revised Actuarial Tables

On June 1, 2023, TD 9974 was published by the IRS, which finalized new actuarial tables that are used regularly for estate planning transactions where interests in annuities, life/term of years, or revisionary interests need to be valued. Between May 4, 2022, and June 1, 2023, taxpayers were able to choose using the new (but not yet final) valuation tables or the predecessor tables. Upon finalizing the new tables, the IRS agreed to allow

tax returns to be amended that used the predecessor tables for transactions that occurred between May 1, 2019, and June 1, 2023. Accordingly, anyone who completed a transaction using the predecessor tables during that time period may wish to evaluate a potential amended tax return. The new valuation tables increase the longevity of the taxpayer, meaning that life interests have increased while remainder interests have decreased — and that can lead to more attractive planning opportunities.

SECURE 2.0 Act

The “SECURE 2.0 Act of 2022” was signed into law by President Biden on December 29, 2022, as part of the Consolidated Appropriations Act, 2023. SECURE 2.0 Act builds on the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, which fundamentally changed the laws regarding distributions from retirement accounts, both during the lifetime and after the death of an IRA account owner.

The SECURE Act increased the required beginning date (RBD) for when an IRA owner has to begin withdrawing required minimum distributions (RMDs) from a traditional IRA from 70 1/2 to 72. SECURE 2.0 Act further increases the RBD to age 73 starting on January 1, 2023, for those who turned 72 after December 31, 2022. SECURE 2.0 will further increase the RBD to age 75 starting on January 1, 2033. Before the change under SECURE 2.0, an IRA owner who turned age 72 (born in 1951) in 2023 would have an RBD of April 1, 2024. The increase in the RBD to age 73 means that IRA owners born in 1951 do not have RMDs for 2023; rather, those IRA owners will have RMDs for 2024, which must be withdrawn by April 1, 2025.

As a result, individuals who reach age 72 are not required to take RMDs

from traditional IRAs in 2023; however, individuals who reach age 73 in 2023 will be required to take the first RMDs from traditional IRAs by April 1, 2024.

SECURE 2.0 creates new limited exceptions to the 10 percent additional tax imposed for certain distributions from traditional IRAs prior to the IRA owner attaining age 59 ½ with the goal of providing flexibility for workers who have unexpected emergency expenses.

The age 50 additional "catch-up" contributions for IRAs have been fixed at $1,000 for a number of years. Thanks to SECURE 2.0, beginning in 2024, the "catch-up" amount will be indexed for inflation. A new concept introduced by SECURE 2.0 is that 401K participants earning more than $145,000 (indexed for inflation) will be required beginning in 2024 to make any "catch-up" contributions into a designated Roth account. As a result, the contribution will be taxable.

Beginning in 2023, SECURE 2.0 brings welcomed changes to some rules regarding qualified charitable distributions (QCDs). Under current law, a QCD allows an IRA owner who is at least age 70 ½ (which SECURE 2.0 did not change) to direct up to $100,000 from his or her IRA per year to public charities. The QCD counts toward satisfying the year's RMD obligation and is excluded from the IRA owner's taxable income. The annual $100,000 QCD limit will also be indexed for inflation beginning in 2024.

SECURE 2.0 now allows a beneficiary of a 529 Plan to make a tax-free rollover of any remaining funds into a Roth IRA (not to exceed the annual Roth IRA contribution limit), provided that the 529 Plan account has been open for at least 15 years.

Before SECURE 2.0, the failure to take RMDs resulted in a penalty tax equal to 50 percent of the RMD amount. This amount could be waived by the IRS for reasonable cause, and the IRS routinely waived the penalty. SECURE 2.0 reduces the penalty to 25 percent of the RMD amount, and the penalty is further reduced to 10 percent if the IRA owner takes corrective action in a timely fashion.

On July 14, 2023, Notice 2023-54 announced that the Department of the Treasury and the IRS intend to issue final regulations related to RMDs under IRC Section 401(a)(9) that will apply no earlier than the 2024 distribution calendar year. In addition, Notice 2023-54 provides guidance related to certain provisions of IRC Section 401(a) (9) that apply for 2021, 2022 and 2023, in particular, that there will be no penalty for failure to take RMDs in 2021, 2022 and 2023 from inherited IRAs subject to the “10-year rule” under the SECURE Act. If a taxpayer has already paid an excise tax for a missed RMD, that taxpayer may request a refund of that excise tax. Notice 2023-54 provides additional rollover relief for IRA distributions made in the first half of 2023 that would have been RMDs if not for changes made in SECURE 2.0.

Important Federal Cases Decided in 2023

United States v. Paulson, 131 AFTR 2d 2023-1743 (9th Cir. May 17, 2023) [EP116-125]

Allen Paulson (the Decedent) died on July 19, 2000, survived by his third wife Madeleine Pickens (Madeleine), three sons from a prior marriage, Richard Paulson (Richard), James Paulson (James) and John Michael Paulson, and several grandchildren, including granddaughter Crystal

Christensen (Crystal). Richard post-deceased his father and was survived by his wife, Vikki Paulson (Vikki). The Decedent's gross estate, valued at approximately $200,000,000, was mostly held in a revocable trust (the Trust). Years after the Decedent's death, following multiple disputes between the Decedent's fiduciaries and beneficiaries, audit inquiries, and failed elections to defer payment of the Decedent's federal estate taxes, roughly $10,000,000 of federal estate taxes, plus interest and penalties, remained unpaid. The United States ultimately brought suit against certain of the Decedent's heirs in their capacities as trustees, transferees or beneficiaries (collectively, the "defendants"), alleging that they were personally liable for the Decedent's unpaid estate tax liabilities pursuant to Code Section 6432(a)(2).

The United States Court of Appeals for the Ninth Circuit (the Court) ultimately reversed the lower court's holding that the defendants were not personally liable for the unpaid estate taxes. In so holding, the Court was the first to interpret the provisions and legislative history of said Section 6432(a)(2) to determine its meaning. Code Section 6432(a)(2) imposes personal liability for a decedent's estate taxes on transferees and others who receive or have property from an estate. It states, in relevant part:

"If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employees' trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercised, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of decedent's death, of such property, shall be personally liable for

such tax” (26 U.S.C. Section 6432(a)(2)).

One question before the Court was whether the limiting phrase “on the date of the decedent’s death” modifies only the preceding verb “has” or also the more remote verb “receives.” The Court ruled in favor of the United States that the phrase “on the date of decedent’s death” does not limit the verb “receives,” holding that Code Section 6432(a)(2) “imposes personal liability for unpaid estate taxes on the categories of persons listed in the statute who have or receive estate property, either on the date of the decedent’s death or at any time thereafter, subject to the applicable statute of limitations.”

In so ruling, the Court followed “the rule of the last antecedent,” which provides that a limiting clause should be read to modify only the noun or verb immediately before it. Contrary to the opinion of the single dissenting circuit judge, the Court also noted that to accept another interpretation would be contrary to the statutory text and context, even though it would be possible, under the decided interpretation, for the personal liability of an individual to exceed the value of the property received by them if such property had significantly declined in value after receipt. Overall, the Court felt there were sufficient safeguards preventing this remote possibility from materializing, especially considering the government’s affirmations that the personally liable transferee is only responsible to the extent of property actually had or received by such individual.

After settling that Code Section 6432(a)(2) imposes personal liability on those categories of persons listed in the statute who have or receive estate property on or after the date of the decedent’s death, the Court was tasked with determining whether the categories of people listed included the

defendants. The Court held that Vikki, Crystal and James were successor trustees of the Trust and therefore liable for unpaid estate taxes in such capacity to the extent of the value of the property included in the Trust at the time of the Decedent's death. The Court also found Crystal and Madeleine liable as beneficiaries of the Trust, finding more broadly, based on contextual case law and analogous statutory usage, that the term "beneficiary" as used in Code Section 6432(a)(2) included a "trust beneficiary." The case was remanded to the district court to calculate the proportion of estate taxes owed by each individual personally liable.

As a practical result of *Paulson*, a nominated successor trustee may wish to inquire as to the liabilities of an estate or trust before accepting the role of trustee. Additionally, executors and trustees should consider withholding distributions until all estate or trust liabilities are satisfied. On the other hand, beneficiaries who receive distributions should learn whether there are any outstanding liabilities of the estate or trust before spending their receipts. In a case where the payment of estate tax was duly deferred, the timeline for observing these precautions may be extended.

Schlapfer v. Comm'r of Internal Revenue, T.C. Memo 2023-65

On May 22, 2023, the Tax Court issued a decision in *Schlapfer v. Comm'r*, T.C. Memo 2023-65, marking its first ruling on what constitutes adequate disclosure of a gift for gift tax purposes under Treas. Reg. 301.6501(c)-1(f)(2). By ultimately applying a "substantial compliance" approach to disclosure, the Tax Court favorably found that the taxpayer met the requirements for adequate disclosure despite not adhering to a stricter standard.

By way of background, Ronald Schlapfer (Taxpayer) had ties to both Switzerland and the United States. In connection with his career, in 1979, Taxpayer moved to the United States from Switzerland and obtained a non-immigrant visa, declaring his intention not to permanently reside in the United States. At the time, Taxpayer's mother, aunt, brother and uncle, his only family, remained in Switzerland. Between 1979 and applying for US citizenship on May 18, 2007, Taxpayer was married, had children, got divorced, and in 1990, was re-married to his current wife (Mrs. Schlapfer) with whom Taxpayer had a son in 1992. Also, in 2002, Taxpayer started his own business, European Marketing Group, Inc. (EMG), a Panamanian corporation that managed investments, holding cash and marketable securities. At the time of EMG's formation, Taxpayer owned all 100 issued and outstanding shares of common stock of EMG.

On July 7, 2006, Taxpayer applied for a LifeBridge Universal Variable Life Policy (the Policy). His stated purpose for taking out the Policy was to create and fund a policy that Taxpayer's mother, aunt and uncle (his brother died in1994) could use to support Taxpayer's nephews. Taxpayer was the initial owner of the Policy, the mother, aunt and uncle were named as the insured, and Taxpayer and Mrs. Schlapfer were designated as primary beneficiaries. On September 22, 2006, the Policy was issued. By November 8, 2006, Taxpayer had transferred $50,000 in cash and his 100 shares of EMG to an account in order to fund the premium payments on the Policy. On January 24, 2007, the Policy was assigned to Taxpayer's mother as owner, and by May 31, 2007, the Policy had been irrevocably assigned to Taxpayer's mother, aunt and uncle as joint owners.

As part of the Offshore Voluntary Disclosure Program (OVDP) meant to give US taxpayers with offshore assets an opportunity to comply with US

tax reporting and payment obligations, in 2012, Taxpayer filed a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return for year 2006, along with several supporting documents. One such document was a protective filing for the gift of 100 shares of EMG, described as a controlled foreign corporation, having a value of $6,056,686. The protective claim stated that the gift was not subject to gift tax because at the time the gift was made, Taxpayer did not intend to reside permanently in the United States. Taxpayer inaccurately reported the gift as a gift of EMG shares and not a gift of the Policy because he thought the Policy was an example of an entity that the OVDP instructions required to be disregarded upon filing. He also stated that the EMG shares were assigned to his mother, even though the ultimate assignment was to Taxpayer's mother, aunt and uncle as joint owners. In June 2014, the IRS responded to Taxpayer's OVDP submission with a request for additional documentation and information, to which Taxpayer timely responded in July 2014.

In January 2016, the IRS opened an examination of Taxpayer's 2006 Form 709. Ultimately, after discussions and the IRS's assertion that the gift was actually a gift of the Policy in 2007 (and not the EMG shares in 2006), the IRS issued a notice of deficiency claiming Taxpayer was liable for $4,429,949 of gift tax and $4,319,200 worth of additions to tax. Both the IRS and Taxpayer filed summary judgment motions with the court, with Taxpayer, on the other hand, asserting that the three-year limitations period applicable to the gift had run, given Taxpayer's adequate disclosure of the gift on his 2006 Form 709. Accordingly, the question before the Tax Court was whether the gift in question, as reported on Taxpayer's 2006 Form 709, satisfied the rules of adequate disclosure such that the statute of limitations had expired before the IRS claimed a deficiency.

Code Section 6501(c)(9) provides that the Commissioner may assess a gift tax at any time if a gift is not shown on a return unless the gift is "disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item." Prior case law provides that disclosure is considered adequate if it is "sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one" (*Thiessen v. Commissioner*, 146 T.C. 100, 114 (2014), quoting *Estate of Fry v. Commissioner*, 88 T.C. 1020, 1023 (1987)). Treasury Regulation 301.6501(c)-1(f)(2) provides that transfers reported on a gift tax return will be considered adequately disclosed if the return provides the following information: (i) a description of the transferred property and consideration received therefor; (ii) the identity of and relationship between each transferee and the transferor; (iii) if transferred in trust, the trust EIN and description its terms, or, in lieu of such a description, a copy of the trust instrument; (iv) a description of the method used to determine the fair market value of the transferred property; and (v) a statement describing any position contrary to any proposed, temporary or final Treasury regulations or revenue rulings.

The provisions of Code Section 6501(c)(9) and analogous Code provisions provide support that information relating to a gift disclosed on documents other than the gift tax return (for example, the supporting documents submitted through the OVDP), is properly considered when analyzing whether the gift was adequately disclosed. Additionally, in Treasury Decision 8845, the IRS provided that its express rejection of a "substantial compliance" approach did not mean "that the absence of any particular item or items would necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall

adequacy of the information provided."

With this as background, the court held that the Taxpayer substantially complied with the requirements of Treas. Reg. 301.6501(c)-1(f)(2) such that the IRS was adequately apprised of the nature of the gift. With respect to requirement (i), even if Taxpayer failed to describe the gift correctly, stating the gift was of the EMG shares and not the Policy itself, he provided sufficient information regarding the underlying asset (i.e., the EMG shares), the value of which primarily comprised the value of the Policy. Regarding Taxpayer's identification of the transferees and his relationship with them, the fact that he inaccurately stated only his mother as a transferee was held immaterial since the other transferees were also family members, and there would be no change to understanding the nature of the gift had his aunt and uncle been identified from the start. Finally, the financial reports of EMG that were provided with Taxpayer's submission to the OVDP were sufficient to allow the court to determine the fair market value of the EMG shares. Thus, the court held that Taxpayer met the requirements for adequate disclosure, and, accordingly, the three-year statute of limitations, including extensions, had expired prior to the IRS's issuance of the notice of deficiency.

Estate of Cecil v. Comm'r of Internal Revenue, T.C. Memo 2023-24 (Feb. 28, 2023)

Estate of Cecil dealt with the gift tax valuation of certain transferred shares of an S Corporation.

Mr. Cecil and Mrs. Cecil (together, Petitioners) were members of the family that built and owned the Biltmore House, an over four-acre, French

Renaissance-style chateau in Asheville, North Carolina (the “Biltmore House”). In 1932, the Biltmore House and its surrounding property were contributed to the Biltmore Company (TBC), which, since 1982, has been classified as an S Corporation. TBC is an operating business in the tourism and hospitality industry, providing visitors an opportunity to enjoy a simulation of the Gilded Age through its tours, hotels, restaurants, retail stores and numerous outdoor activities. Over the years of operating TBC, the Cecil family had instituted various policies and agreements severely limiting the transfer of TBC shares in general and especially outside the family.

As permitted by the TBC operating agreement, in November 2010, Mrs. Cecil made a gift of her one share of TBC Class A common stock to her children, Bill Cecil and Dini Pickering, in undivided equal shares. One day later, Mr. Cecil, as trustee of his revocable trust, transferred his 9,337 shares of TBC Class B common stock, first to himself, then to his five grandchildren, subject to trusts. The Class A shares carry one vote per share; the Class B shares have no voting power. Petitioners timely filed gift tax returns for 2010, reporting the gifts and electing to split them, reporting their total taxable gifts in 2010 as $10,438,766 each. The IRS audited Petitioners’ 2010 returns and ultimately issued notices of deficiency of $13,022,552 of gift tax, taking issue with the valuation approach used by the Petitioners’ appraiser and the discounts applied.

While Petitioners’ appraiser used the income approach (which capitalizes income and discounts cash flow) and market approach (which compares the subject property with similar property subject to an arms-length sale around the same time), the IRS believed an asset-based approach (which values property by determining the cost to reproduce it, for example, by

looking at the fair market value of a corporation's net assets), was proper. The US Tax Court ultimately determined that because TBC is an operating company unlikely to be liquidated, its value is better measured by its earnings than its assets, upholding the valuation method selected by the Petitioners' appraiser.

In doing so, the court ruled that "tax affecting" was properly applied in this case. Tax affecting is a valuation mechanism by which a hypothetical entity-level tax is applied to the taxable income of a pass-through entity such as an S Corporation. The rationale behind tax affecting is that since the income received by the shareholders is subject to income tax, such tax liability, even though not directly assessed on the pass-through entity, should be taken into account when valuing the entity. Here, although the parties' appraisers disagreed as to the method of valuation of TBC, all agreed that the value should be tax-affected, and the court so ruled. However, the court stopped short of providing factors for when tax affecting was appropriate generally, limiting the holding strictly to the facts at hand.

The final issue determined by the court was the discounts applicable to the transferred shares of TBC. The court accepted the Petitioners' appraiser's 20 percent discount for lack of control while rejecting the IRS's appraiser's assessment of a 2 percent discount for lack of voting rights of the Class B shares (given that such shares did have voting power in limited circumstances). Finally, for lack of marketability, the court applied different discount rates depending on the class and number of shares transferred — 19 percent to the Class A common stock, 22 percent to the smaller block of Class B common stock, and 27 percent to the larger block of Class B common stock. The court held that since a smaller block of Class B shares of TBC would be more easily marketed than a larger block of Class B

shares of TBC, different discount rates for these two blocks were appropriate, and since the voting rights attaching to the Class A shares of TBC make such shares more attractive to a buyer, a third discount rate was appropriate for this class of stock.

Pending Proposals From the Biden Administration

The Biden Administration released its tax proposals for fiscal year 2024 by publishing its *General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals* (the "Green Book") in March 2023. Importantly, ***the Green Book is not proposed legislation*** and would need to pass through Congress like any other legislation in order to be binding. Nevertheless, the Green Book serves as "a peek behind the curtain" with respect to the priorities the Biden Administration wishes to pursue in the event the 2024 election yields favorable results for the Democratic party.

Individuals

The Biden Administration has proposed significant changes with respect to the taxation of capital gains and the taxation of accumulated wealth. For example, the Green Book proposes a return to the 39.6 percent top marginal tax rate (up from the present 37 percent), as well as increasing the net investment income tax and Medicare tax by an additional 1.2 percent each. In addition, the Green Book proposes that taxpayers whose income exceeds $1,000,000 ($500,000 for married filing separately) will be taxed at ordinary income rates for long-term capital gains and qualified dividends that traditionally are taxed at lower rates. Furthermore, the Green Book proposes a 25 percent minimum tax (inclusive of unrealized gains) for individuals whose total net worth exceeds $100,000,000 (and would further

impose an annual reporting requirement on such individuals).

Corporations and Partnerships

The Biden Administration's proposals at the entity level are largely similar to past proposals. The Green Book proposes to raise additional revenue through an increase in the corporate tax rate (from 21 percent to 28 percent). Additionally, the Green Book seeks to target corporate stock transactions, as well as address the so-called "carried- interest loophole."

Trusts and Estates

The Biden Administration has again proposed significant changes to the areas affected by the estate and gift tax. As drafted, the Green Book would substantially change common estate planning instruments, like treating a grantor's payment of an irrevocable grantor trust's income taxes as a taxable gift, treating a sale to a grantor trust as a recognition event, effectively eliminating the usefulness of GRATs by having arduous requirements for the length of the GRAT's terms and value of the remainder interest, and imposing an annual maximum of $50,000 for total annual exclusion gifts. Additionally, the Biden proposal would roll back the applicable exemption amount to pre-TCJA levels ($5,000,000 adjusted for inflation).

International Developments

With the world finally seeming to put the COVID-19 pandemic era comfortably in its rear-view mirror, this year has been characterized by everyone, including tax authorities, putting their eyes back on the road

ahead. The IRS has planned its future strategy and published a roadmap of what it wishes to accomplish. Among the goals is a renewed focus on high-income taxpayers and large corporations, as the IRS has noted that these certain taxpayers often use nuanced structures involving international elements. The IRS's ability to accomplish its planned goals has been buttressed by the Corporate Alternative Minimum Tax, which begins taking effect for tax years starting in 2023, and the CTA, which comes into effect at the start of 2024. The United States is not alone in shifting its priorities as foreign governments renew their efforts to implement a global minimum tax. Nevertheless, this renewed focus on international tax compliance and reporting across borders has come with certain growing pains in the forms of taxpayer-supported litigation. We have included a summary of the more material developments affecting the international private client landscape in 2023 and beyond.

United States and Chile Tax Treaty and Additional Tax Treaty Developments

As much as the US government and the IRS are looking forward, they have also taken up the task of progressing with items of past importance. One such item is the dual tax treaty between the United States and Chile. The US-Chile Tax Treaty was first signed more than a decade ago and has awaited US congressional approval to begin its steps toward ratification. After a long period of waiting, the Senate finally approved the treaty in June 2023, subject to additional reservations. These reservations mostly arise from changes in the US tax code introduced by the TCJA. The treaty still faces a number of hurdles before ratification, including being approved by President Biden and re-ratification of the treaty by Chile subject to the Senate's reservations.

While the United States has moved forward with the ratification of a new tax treaty, the Russian government has suspended a number of tax treaties. Countries affected by this suspension include the US, Canada, Japan, Australia, and a large number of European Union countries. It is unknown for how long these treaties will be suspended, but it is unlikely to change without a material shift in the nature of the Russia-Ukraine war.

OECD Pillar II and the Global Minimum Tax

The ongoing process of instituting a global minimum tax continued in 2023. A number of new countries put in place laws to meet the requirements set out by Pillar II. These developments have led countries such as Switzerland to estimate that they will see increases in tax revenue of hundreds of millions of dollars, but the United States has estimated that it may see a decrease in tax revenue with the implementation of a global minimum tax. These estimated decreases in tax revenue come from a potential increase in taxes paid in countries other than the US and the accompanying foreign tax credits.

The United States' Corporate Alternative Minimum Tax, which is effective for 2023, is grounded in similar principles to that of the OECD's Pillar II, but it is not sufficiently similar to bring the United States into compliance with Pillar II. The United States' lack of compliance with Pillar II and the additional difficulties that entities may experience as countries begin to implement Pillar II has led to the creation of a transitional rule for the Undertaxed Profits Rule or "UTPR," a key aspect of Pillar II. This transitional rule states that the top-up tax in the jurisdiction of a company'sultimate parent applied by the UTPR will be nothing for each fiscal year of the transition period if that jurisdiction has a corporate tax rate

of at least 20 percent.

More simply, multinationals headquartered in countries with at least a 20 percent corporate tax rate would not be subject to the re-apportioning of taxable income to other countries where they have a footprint under the UTPR. As stated earlier, this is only a transitional rule applying for fiscal years no longer than 12 months that begin before December 31, 2025, and end before December 31, 2026.

IRS Actions: Proposed Regulations and Clarifications

Like Congress and the OECD, the IRS has also been active in 2023, providing proposed regulations and clarifying points of law. With increased scrutiny of high-income taxpayers, the IRS has shifted its so-called “Dirty Dozen” list of tax scams and tax avoidance schemes to include more items used by high-income taxpayers or containing an international element. One such transaction added to the Dirty Dozen list in 2023 is the use of Maltese Retirement Plans by US taxpayers. While the use of a Maltese Retirement Plan does not per se create problems, the IRS has noted that the use of a Maltese Retirement Plan in conjunction with a position taken under the US and Malta Tax Treaty can result in US taxpayers improperly claiming certain income to be exempt from US income tax.

The proposed regulations under Treas. Reg. § 1.6011-12 would require disclosure of direct and indirect transactions with a Maltese Retirement Plan by US citizens and US income tax residents who transfer cash or property to a Maltese Retirement Plan. This disclosure requirement would also include US taxpayers who receive a distribution from a Maltese Retirement Plan and take a position on their federal return that income or gains from

such distributions are not includible in their income under the US and Malta Tax Treaty. The Proposed Regulations include an exception to the disclosure rules for individuals using a Maltese Retirement Plan under certain circumstances; however, this exception is planned to be phased out after a currently undetermined applicable date.

Outside of the Proposed Regulations, the IRS has published Advice Memorandum 2023-003 providing further clarification on the Publicly Traded Stock Exception for a US Real Property Holding Corporation or "USRPHC" in Code § 897(c)(3). This exception allows individuals who own less than 5 percent of a class of publicly traded stock of a USRPHC to avoid such stock being treated as a US Real Property Interest. Gain resulting from the disposition of a US Real Property Interest by a non-US taxpayer is treated as effectively connected income and taxed at graduated rates. The Advice Memorandum clarifies this point when interests in a publicly traded USRPHC are owned through a foreign partnership by applying the 5 percent rule at the partnership level under an entity theory of partnerships. Therefore, if a foreign partnership owns more than 5 percent of a publicly traded USRPHC, gain from a disposition of such USRPHC interest will be considered ECI to the partners.

Taxpayer Victories at Home and Abroad

While most of our international update has focused on growth and changes put forward by the United States and other national governments, a few cases brought forward by taxpayers have shaken or attempted to shake up the landscape with regard to US tax reporting. The first case, *U.S. v. Bittner*, saw the Supreme Court answer the oft-asked question of whether non-willful penalties for failure to file FinCEN Form 114, more commonly called

an “FBAR,” should be assessed on a “per form” or “per account” basis. The IRS has long supported the belief that the $10,000 non- willful failure to file penalty should be assessed for each unreported foreign account, leading certain individuals to face assessments of more than $1,000,000. Taxpayers generally have favored the per form belief that the $10,000 penalty applies per FBAR that should be filed no matter how many accounts are reported on such form. In *Bittner*, the taxpayer was successful, and the Supreme Court agreed with the per-form argument, settling a previously existing split among US Circuit Courts. It is unknown how exactly this will change pending or past litigation for non-willful FBAR penalties, but there is already litigation currently underway requesting reduced fees pursuant to the decision in *Bittner*.

The Foreign Account Tax Compliance Act, commonly known as “FATCA,” has been challenged by lawsuits abroad. FATCA requires banks and financial institutions outside of the United States to share information on their US account holders with the US government. In the first case, the Supreme Court of Canada dismissed a case brought forward by two dual citizens of Canada and the United States. Both taxpayers argued that FATCA violated their rights under the Canadian Charter of Rights and Freedoms; however, the court did not agree by dismissing their claim, thereby making it ineligible for appeal.

A similar case was brought forward in Belgium by the Association of Accidental Americans of Belgium. Initially, the Belgian Data Protection Authority found that FATCA violated the European Union’s General Data Protection Regulation, including specific sections related to the transfer of data outside of Europe, and instructed the Belgian Federal Public Service Finance to stop such transfers of data. The Brussels Court of Appeals later

suspended this ruling while the merits of the case are considered on appeal, allowing for the continued flow of data to the United States. With this case being relevant to American citizens across the EU, there is speculation that this case may eventually be heard by the Court of Justice of the European Union.

Overall, 2023 saw a number of changes in the global private client landscape as well as continued development, laying the foundations for further changes to come. These developments have brought successful taxpayer challenges in the United States and abroad. With new tax regimes coming into effect in 2024 and beyond, we may see an increase in taxpayer challenges pushing back against the ever-shifting landscape.

Developments in Unique Assets

Artwork

For institutions and private collectors, restitution was the major theme affecting ownership of artwork in 2023, especially for antiques and WWII-era art. The Manhattan District Attorney prosecuted a number of high-profile restitution cases this year, seizing artwork from museums, collectors and dealers and returning the works to the countries or individuals deemed to be lawful owners. In addition, some institutions, including the Metropolitan Museum in New York, have separately taken the initiative to review and return works from their collections.

The existence of a potential claim against an artwork will invariably affect its salability and, therefore, its value. Despite that, the IRS remains skeptical of valuation discounts proffered by taxpayers based on the fact that an artwork

may be potentially stolen or looted. Certain IRS challenges to valuations for estate tax purposes in 2023 will offer a test case for how such disputes are litigated and resolved.

Non-Fungible Tokens (NFTs) and Cryptocurrency

The IRS issued its first published guidance related to NFTs in 2023. In Notice 2023-27, the IRS announced that it and the Department of the Treasury intend to issue guidance related to the treatment of certain NFTs as collectibles under IRC Section 408(m). As defined in the Notice, an NFT is a "unique digital identifier that is recorded using distributed ledger technology and [which] may be used to certify authenticity and ownership of an associated right or asset." The intended guidance would determine whether an NFT constitutes a collectible by "looking through" the NFT to see whether the associated right or asset is a collectible under Section 408(m). Among other implications, whether an NFT is determined to be a collectible would affect the long-term capital gains rate applicable on the sale or exchange of the NFT, as the maximum rate for non-collectibles is generally lower than the 28 percent maximum rate applicable to collectibles. In addition, an individual retirement account (IRA) that acquires a collectible is treated as having made a distribution equal to the cost of the collectible.

The IRS also issued guidance on the taxation of cryptocurrency received as rewards for staking. "Staking," in short, refers to the practice of validating transactions on certain blockchains, which is the technology underlying many cryptocurrencies. Successful validations strengthen the integrity of the blockchain. To incentivize participation in staking, some blockchains, as well as some cryptocurrency exchanges, offer cryptocurrency as a reward. In Rev. Rule 2023-14, the IRS ruled that for cash-method taxpayers,

cryptocurrency received as a reward for staking is taxable income. The rewards are to be included in gross income in the taxable year when the taxpayer gains dominion and control over them, and the value of the rewards to be included is the fair market value as of the date and time the taxpayer gains dominion and control over them. Rev. Rul. 2023-14 was issued shortly after oral arguments before the Sixth Circuit Court of Appeals in *Jarrett v. United States*, in which the taxpayer-couple argued that they should not be taxed on their staking rewards. The District Court had dismissed the case for mootness because the IRS had already refunded the tax on the rewards despite the taxpayer's rejection of the refund, and the Sixth Circuit affirmed.

In REG–122793–19, the IRS and the Department of Treasury issued expansive proposed regulations for reporting cryptocurrency transactions. Although the proposed regulations mostly pertain to reporting by brokers, they also propose rules for reporting real estate transactions involving digital assets, for encompassing digital assets in the rules for determining adjusted and initial basis in securities and for making digital asset transactions subject to backup withholding.

Under IRS Notice 2014-21, "convertible virtual currency," which includes cryptocurrencies, is treated as property for federal tax purposes. Nevertheless, many trustees may be hesitant to accept cryptocurrencies as part of the trust estate of a trust, at least until further guidance is provided. This year, the IRS clarified in Memorandum CCA 202302012 that because convertible virtual currency is treated as property, not cash, claiming a charitable deduction in excess of $5,000 for a donation of cryptocurrency requires a qualified appraisal under IRC Section 170(f)(11)(C). The Memorandum also provided that a determination of the cryptocurrency's

value, based on the value reported by an exchange on which the cryptocurrency is traded, will not excuse noncompliance with the qualified appraisal requirement. It remains to be seen how comfortable qualified appraisers will be to wade into the waters of issuing reports on the value of cryptocurrency or NFTs.

Regarding the practicalities of owning cryptocurrency, the collapse of the cryptocurrency exchange, popularly known as FTX and other horror stories offer a reminder about the importance of speaking with an attorney about cryptocurrency holdings. At the very least, cryptocurrency owners should understand the different options for storing the information that allows them to access, control and transfer their holdings, and they should either provide a trusted contact with that information or ensure that their fiduciary can find this information after they have passed. While this information may potentially be retrievable if stored online or with an exchange, in that case, such information may be vulnerable to hacking. In addition, whether cryptocurrency stored on an exchange belongs to the exchange rather than the account owner and is, therefore, reachable by creditors of the exchange in bankruptcy is currently an open question. At a minimum, the exchange's terms of doing business (or equivalent agreement) should be reviewed to ensure that the exchange acknowledges that the cryptocurrency belongs to the account owner. Conversely, while storing this information offline is the safest method in terms of both security and creditor protection, the cryptocurrency may be permanently inaccessible if the information is lost. While it may be treated as property for tax purposes, cryptocurrency proves to be quite unlike other forms of property in terms of transferring ownership postmortem.

California Updates

California Imposes State Tax on Incomplete Gift Non-Grantor Trusts (INGs)

On July 10, 2023, California Governor Gavin Newsom signed Senate Bill 131 (SB 131) into law, which included a provision targeting the California state income tax treatment of incomplete gift non-grantor trusts (INGs). Prior to the enactment of SB 131, the income of a non-grantor trust was subject to California income tax only if the trust had California-sourced income, a fiduciary residing in California, or a non-contingent California resident beneficiary (i.e., a beneficiary entitled to distributions). INGs have been used as an estate planning tool by residents of high-income tax states, such as California, primarily as a strategy for avoiding state income taxes. An ING is typically funded when a grantor makes an incomplete gift to an irrevocable non-grantor trust in another state, for example, Nevada (referred to as a NING) or Delaware (DING). Because the gift by the grantor is not completed, the assets remain in the grantor’s estate for estate tax purposes. The trust’s income, on the other hand, is reported on the trust’s tax return and is considered income of the trust and not the grantor. As the income is taxed to the trust, if an ING is established in a state with no income tax, the trust will only pay the federal income tax, and no state income tax will be due.

Prior to the implementation of SB 131, a California grantor who funded an ING was not required to report the trust’s income on the grantor’s California state income tax return unless the grantor received a distribution of distributable net income (DNI) from the ING during the taxable year. Under the new Revenue and Taxation Code Section 17082, established by SB 131, the income realized in an ING is included in the income of the grantor, effectively treating the trust as though it were a grantor trust. A

California resident grantor of an ING established in another jurisdiction is required, retroactive to January 1, 2023, to report the income of such out-of-state ING on the grantor's California state income tax return as though the ING were a grantor trust. All of the ING's income, whether California source income or non-California source income, will be includable in the grantor's income and subject to taxation in California.

Section 17082 contains a limited charitable exception pursuant to which an ING will not be treated as a grantor trust. To qualify for the exception, an ING must file a California Fiduciary Income Tax Return and make an irrevocable election to be treated as a resident non-grantor trust. The California Fiduciary Income Tax Return must provide that 90 percent or more of the ING's DNI is to be distributed, or treated as distributed, to a charitable organization. If an ING can meet this exception, then the ING will not be treated as a grantor trust for California income tax purposes.

The law is retroactive to January 1, 2023, and unlike New York, which passed its own anti-ING legislation, California did not grant a grace period to allow grantors of INGs to adjust their estate planning to account for the retroactive application of the new regulation. Grantors of INGs who have relied on such trusts to avoid income taxation of non- California source income should discuss the new law with estate planning counsel and develop a strategy to respond to the change in the law.

California Passes Uniform Directed Trust Act

On October 10, 2023, Governor Newsom signed the California Uniform Directed Trust Act (UDTA) into law. A directed trust is a trust pursuant to which some person other than the trustee of the trust, such as a trust

advisor or trust protector, has power over an aspect of the trust's administration. A directed trust can raise confusion and difficult questions concerning the roles of multiple fiduciaries, such as what duties are owed by each such fiduciary to the trust's beneficiaries. The UDTA will provide a method for regulating directed trusts and will set forth the duties and responsibilities of the non-trustee fiduciaries and the duties and responsibilities of the directed trustee, including specifying what powers may be given to a non-trustee fiduciary and the information required to be exchanged by the non-trustee fiduciary and the directed trustee. The UDTA will require a directed trustee to take reasonable actions to comply with a non-trustee fiduciary's exercise or non-exercise of a power of direction, except that the directed trustee is not required to comply with a non-trustee fiduciary's exercise or non-exercise of a power of direction to the extent that, by complying, the trustee would be deemed to engage in willful misconduct. The UDTA will exempt from duties and liabilities under the act a non-trustee fiduciary who is licensed, certified, or otherwise authorized or permitted by law to provide health care in the ordinary course of the non-trustee fiduciary's business or practice of a profession to the extent the non-trustee fiduciary acts in that capacity in his, her or its administration of the trust.

The UDTA goes into effect on January 1, 2024.

California Adopts Uniform Fiduciary Income and Principal Act

On June 29, 2023, Governor Newsom signed the Uniform Fiduciary Income and Principal Act (UFIPA). The new law repealed the Uniform Principal and Income Act (UPIA) and replaced it with the UFIPA, which was established by the Uniform Law Commission in 2018 and has been adopted by seven

states, including California. UFIPA seeks to modernize trust administration and accounting to take into account changes in financial markets and investment strategies that have come to light following the implementation of UPIA. UFIPA includes specific changes that will alter the way fiduciaries allocate income and principal, allocate tax receipts, and make trust distributions.

Under the current UPIA regime, fiduciaries are guided by the prudent investor rule, and a fiduciary can only adjust from income to principal or principal to income if certain conditions are met, including compliance with the Prudent Investor Act. UFIPA abandons the prudent investor rule and expands a fiduciary's power to allocate between income and principal "if the fiduciary determines the exercise of the power will assist the fiduciary to administer the trust or estate impartially." (UFIPA, Section 16327.) A stated purpose of UFIPA is to give fiduciaries the power to invest trust assets holistically, permitting them to focus on the maximum total return of the trust's assets, whether the return is in the form of income or growth of trust principal. UFIPA also makes several changes to the laws governing the administration of unitrusts, including specifying certain factors a fiduciary is required to consider when making various changes related to unitrusts. Contrary to current law, UFIPA permits a court to authorize a unitrust rate that is less than 3 percent or greater than 5 percent. UFIPA also provides new guidance for judicial reviews of a trustee's exercise of his or her duties to the trust's beneficiaries, makes changes to the allocation of liquidating assets, and provides a default rule that the situs of the trust applies unless the terms of the trust specify another jurisdiction.

UFIPA goes into effect on January 1, 2024.

Discretionary Reimbursement of Tax Liability Goes Into Effect

As noted in Katten's 2022 Year-End Estate Planning Advisory, effective as of January 1, 2023, section 15304 subsection (c) was added to the California Probate Code, which settled a previously debated area of California law concerning the reimbursement of taxes paid by settlors of irrevocable trusts. Prior to the enactment of section 15304(c), when a settlor granted a trustee the power to reimburse the settlor for income taxes paid on behalf of the trust, such power could arguably have been deemed a beneficial interest in the trust retained by the settlor which could cause the trust's assets to become subject to the claims of the settlor's creditors. Section 15304(c) confirms that under such circumstances, a settlor is not considered a beneficiary of an irrevocable trust created by the settlor solely by reason of a discretionary authority vested in the trustee to pay directly or reimburse the settlor for any federal or state income tax on trust income or principal that is payable by the settlor. Section 15304(c) makes clear that a settlor of a trust who irrevocably gives property to the trust for the benefit of others but who is personally responsible for taxes on the trust property may be reimbursed for those taxes without the settlor's creditors gaining access to the transferred property.

California Wealth Tax Bill Receives Significant Opposition

On January 19, 2023, the California legislature introduced Assembly Bill 259 (AB-259), which seeks to adopt new taxes on the worldwide net worth of every resident, part-year resident, temporary resident or "wealth tax resident" in California. The tax would be a 1.5 percent tax on "worldwide net worth" in excess of $1 billion for an individual or $500 million for a married taxpayer filing separately beginning in 2024, a 1 percent tax on

worldwide net worth in excess of $50 million for an individual filer and $25 million for a married filer beginning in 2026, and a .5 percent surtax on "worldwide net worth" in excess of $1 billion for an individual or $500 million for a married taxpayer filing separately beginning in 2026.

The bill has received considerable opposition since its introduction, including from Governor Newsom, amid concerns regarding the constitutionality of the bill and the effect the bill would have on a "wealth exodus" from California should it be adopted. While it appears that the bill is not likely to receive significant support, it is important to note its introduction and to follow any subsequent updates as the bill's sponsors attempt to move the bill through the legislature or as other similar bills are proposed.

California Courts Split Concerning Trust Modifications, Await Supreme Court Review

California courts remained split concerning the required procedure for modifying trusts. As previously reported, the Third District Court of Appeal in *Pena v. Dey* (2019) 39 Cal.App.5th 546 and the Fifth District Court of Appeal in *King v. Lynch* (2012) 139 Cal.App.4th 1186 have held that when a trust sets forth a method or procedure for trust modification, that method must be followed in order for a modification to be effective, regardless of whether the trust expressly provides that the method is the exclusive method of modification. The decisions of the Third District and Fifth District were joined by the First District Court of Appeal last year in *Balistreri v. Balistreri* (2022) 75 Cal.App.5th 511, which adopted the restrictive view and held a trust amendment invalid for lack of notarization where the trust provided that any amendment to the trust had to be acknowledged before a notary to be valid.

Contrasting the restrictive views of the First, Third and Fifth Districts was that of the Fourth District Court of Appeal in *Haggerty v. Thornton* (2021) 68 Cal.App.5th 1003. The *Haggerty* court concluded that the statutory provisions of California Probate Code sections 15401 and 15402, which govern modifications and revocations of California trusts, are to be understood as codifying the common law principle that unless a trust specifically provides that a method of modification set forth in the trust is exclusive, the stated method is not exclusive and the statutory procedure of revocation is also an available procedure of modification. The *Haggerty* ruling is currently pending before the Supreme Court, and the Balistreri ruling is pending the Supreme Court's decision in *Haggerty*.

Interestingly, despite the California Supreme Court having taken up the issue of the district court split, the Second District Court of Appeal joined the fray in 2023. In *Diaz v. Zuniga* (2023) 91 Cal.App.5th 916, a settlor, Mateo Diaz (Mateo), executed a revocable trust, of which he was sole trustee, which became irrevocable upon his death. The original trust called for one piece of real property to be distributed equally to all of settlor's seven siblings, with a second piece of real property being distributed to Mateo's relative, Marisela Zuniga (Marisela). Soon after Mateo's death, a purported trust amendment dated 2007 was found among papers in a container kept in Mateo's bedroom closet in a stamped envelope addressed to Mateo's attorney. Among other changes, the purported amendment substantially diminished the gift meant for Marisela, reducing her interest in the second property to 10 percent of the property's value.

Article X of the trust provided that "The Trustor may at any time during Trustor's lifetime amend any of the terms of this instrument by an instrument in writing signed by the Trustor and delivered by certified mail to

the Trustee." The trust did not explicitly state that the method for modification set forth in Article X was the exclusive method of modification. Following Mateo's death and the discovery of the purported amendment, the co-trustees, one of whom was Marisela, filed competing petitions for instruction concerning the validity of the purported trust amendment. After trial, the court held the amendment invalid for failing to comply with the requirement that the settlor deliver the amendment via certified mail to the trustee, i.e., to himself.

On appeal, the appellate court upheld the trial court's ruling. The court recited the history of *Haggerty* and *Balistreri* and discussed the legislative history of sections 15401 and 15402 of the California Probate Code, ultimately agreeing with the holdings of *Balistreri*, *King* and *Pena*. The court found that the settlor's intent was manifest by specifically requiring the onerous step of delivering any trust amendment by certified mail to ensure that any such amendment would be bona fide and not the product of fraud. The court also found it significant that the amendment was found in a closet, indicating the settlor had not intended it to be binding absent further action. The court held, consistent with the *Balistreri* court, that a specified method of modification, even if not expressly made the exclusive method of modification, is nonetheless required for an amendment to be valid.

While the California Supreme Court considers this issue, and as we await an ultimate decision to resolve the circuit split, it remains a prudent drafting strategy to include an explicit statement in any trust instrument that directly sets forth the method of amendment or modification and which provides whether such procedure is the exclusive method by which the trust may be modified. We will be closely monitoring the Supreme Court's decisions in these cases.

Trustee Neutrality: Taking a Position Can Be Costly

In *Zahnleuter v. Mueller* (2023) 88 Cal.App.5th 1294, Richard and Joan Mueller created a living trust as settlors, naming the two children of their marriage, Katherine and Amy, as residuary beneficiaries and as successor trustees. The trust provided, in pertinent part, as follows: “the Trustee is authorized to defend, at the expense of the Trust Estate, any contest or other attack of any nature on this Trust or any of its provision, but provided that the paragraph shall not apply to any amendment of this document . . . executed after the date of this document.”

The settlors executed two amendments to the trust prior to Joan’s passing, and Richard allegedly executed two versions of a third amendment to the trust following Joan’s death. The first and second versions of the third amendment substantially altered the dispositive terms of the trust, including adding gifts for the children of Richard’s brother, Thomas, and appointing Thomas as successor trustee. None of the amendments or purported amendments revoked or amended the trust language expressly prohibiting a trustee from defending at the expense of the trust a contest to an amendment to the trust. Following Richard’s death, Katherine challenged the validity of the second version of the third amendment, alleging the amendment was the product of fraud and undue influence. Thomas, in his capacity as trustee of the trust, filed an opposition to Katherine’s petition. More than two years after filing her petition contesting the validity of the third amendment, Katherine filed a petition to compel an accounting and to surcharge Thomas for the use of trust funds to defend against Katherine’s contest. The trial court granted Katherine’s petition surcharging Thomas $201,164.15, and Thomas appealed.

On appeal, Thomas argued that he properly expended trust assets to defend against Katherine's contest to the validity of the third amendment and that the surcharge order should be reversed. The appellate court disagreed, holding that by defending the third amendment, Thomas improperly pursued the interests of the beneficiaries under the third amendment over the interests of the beneficiaries under the earlier amendments and that the trustee's involvement did not benefit the trust itself. The court held that the fact that the trustee himself did not have a direct beneficial interest in the third amendment was irrelevant to the question of the trustee's neutrality and held that because the trustee did not participate as a neutral party in the dispute, he could not expend trust resources in defending against the contest.

The *Zahnleuter* case is a stark reminder and warning to trustees to remain neutral in disputes between and among beneficiaries of the trust and to carefully consider whether a dispute concerning the validity of a trust or amendment invites the trustee to expend trust resources or otherwise take a position concerning the dispute. A trustee is not entitled to reimbursement of litigation expenses from the trust estate when, as in Zahnleuter, the dispute concerns who will enjoy the benefits of the trust or who will control the trust.

Illinois Updates

Illinois Notary Public Act – Final Administrative Rules Adopted

The Illinois Secretary of State adopted finalized administrative rules regarding the Illinois Notary Public Act on June 5, 2023 (Final Rules). The Final Rules detail the three methods of notarization available in Illinois: (1)

traditional in-person notarizations, (2) remote notarizations, and (3) electronic notarizations. Additionally, the Final Rules changed the provisions regarding the process for those wishing to obtain or renew their notary public commissions to be effective as of January 1, 2024. Another important change the Final Rules added to notarizations is the recordkeeping requirement on what information a notary must record and keep in their notary journals.

Electronic Wills, Electronic Estate Planning Documents and Remote Witnesses Act

On July 28, 2023, an amendment to the Electronic Wills and Remote Witnesses Act was passed that changed the name of the Act to the Electronic Wills, Electronic Estate Planning Documents, and Remote Witnesses Act. This amendment added provisions for electronic signatures and electronic notarizations of nontestamentary estate planning documents. However, these new provisions do not apply to nontestamentary estate planning documents that expressly prohibit the use of electronic signatures or records. These changes are to be effective as of January 1, 2024.

In re Estate of Topal, 2022 IL App (4th) 210613 (October 24, 2022)

In *Topal*, the decedent owned residential property located in Illinois that was subject to a mortgage held by Associated Bank, N.A. (Associated Bank) at the time of his death in March 2017. In the years following the decedent's death, Associated Bank did not file any foreclosure action, nor was it able to file a claim against the decedent's estate because no estate had been opened at the time. Once the decedent's estate was opened, the estate moved to bar all claims arising out of the mortgage on the property. The

estate cited the two-year filing limitation under the Illinois Probate Act, which states that all claims against an estate are barred two years after a decedent's death.

The appellate court held that Associated Bank was barred from bringing its claims against the estate after the two- year claims period had expired. The court also stated that although Associated Bank was time-barred from filing its claim against the estate, it could still bring its foreclosure action against the property that was subject to the mortgage.

Shaw v. U.S. Financial Life Insurance Company, 2022 IL APP (1st) 211533 (Nov 16, 2022)

In *Shaw*, a husband (Husband) listed his former wife (Former Wife) as the beneficiary on his life insurance policy, with his three children as the contingent beneficiaries. When Husband and Former Wife dissolved their marriage in March 2016, the divorce judgment was silent on the proceeds of the life insurance policy. When Husband died in February 2020, it was discovered that Former Wife was still listed as the beneficiary on this life insurance policy.

On January 1, 2019, a new law in Illinois became effective, which changed how life insurance policy proceeds are paid out when there was a dissolution of marriage. The change to the law provided that a dissolution of marriage during the insured spouse's lifetime operates as if the insured spouse had revoked the beneficiary designation of naming the former spouse as the beneficiary. Because this statute became effective after the dissolution of marriage between Husband and Former Wife in 2016, but before Husband died in 2020, the court was tasked with determining when

this statute applies.

The appellate court affirmed the trial court's finding that the trigger of the application of the statute was the date of the dissolution of marriage and not the date of death. Because the date of the dissolution of marriage between Husband and Former Wife occurred in 2016, which occurred years before the enactment of this statute, this statute did not apply in this scenario. Therefore, Former Wife was entitled to the proceeds of Husband's life insurance policy.

In re Estate of Johnson, 2023 IL App (4th) 220488 (April 26, 2023)

In Johnson, a father (Father) executed his will in February 2001 and named his brother (Brother) as the sole beneficiary of his estate. In 2004, Father married his wife (Wife), and later, Father adopted his wife's four adult children in 2012. Father then died in December 2020 without changing his will. After Father's death, Brother filed a petition to get the will admitted to probate and was appointed the executor of the estate. Wife renounced the will and elected for the statutory spousal share. The adopted adult children filed a petition stating that although they were adopted by Father after execution of his will, they were never specifically disinherited, and therefore, they were each entitled to a share of Father's estate.

Under Illinois' Probate Act, children of a decedent who are not provided for or explicitly disinherited have rights to receive a share of the estate as if the decedent had died intestate (or without a will). The Probate Act also states that adopted adult children who never resided with the adopting parent before reaching the age of 18 would be considered children of the adopting parent for purposes of inheriting from such parent but would not be

considered a descendant of the adopting parent for purposes of inheriting from the extended family of that adopting parent. Based on this, the trial court in *Johnson* determined that the adopted children had rights under Illinois law to elect to receive the share of Father's estate they would have received if he had died without a will.

On appeal, the court determined whether the subterfuge exception to this adoption of the adult children occurred. The subterfuge exception established in *Cross v. Cross*, 177 Ill. App. 3d 588 (1st Dist. 1988) states that the adoption of an adult child for the sole purpose of making him or her an heir of an ancestor under the terms of a testamentary instrument that is known by the parties and in existence at the time of the adoption is considered an act of subterfuge. The appellate court in *Johnson* determined this exception did not apply in this case. The estate in question was that of the adopting parent, who could not commit an act of subterfuge against himself. Additionally, the court noted Father could have altered his estate plan to specifically exclude or disinherit his adopted children if that was his intention; however, he chose not to make such updates to his estate planning documents.

Beck v. Pact, 2023 IL App (1st) 221120 (June 30, 2023)

In *Beck*, the appellate court affirmed the trial court's ruling that the irrevocable trust created by Grantor could not be modified. Grantor created an irrevocable trust of which he was the sole beneficiary during his lifetime. The trust was intended to benefit Grantor during his lifetime and continue in trust for certain family members after his death. However, Grantor later sought to modify the terms of the trust to direct the trust to terminate upon his death rather than continue in trust for the named contingent

beneficiaries. Grantor also sought to modify the terms of the trust by giving Grantor the power to remove or replace any trust protector, give Grantor the power to name successor trust protectors and strip current trust protectors of their power to name successors.

The circuit court ruled that neither the Illinois Trust Code (ITC) nor the trust instrument allowed the requested modifications by Grantor. The circuit court looked to Section 411(b) of the ITC, which states that a noncharitable irrevocable trust may be modified with the consent of all beneficiaries if the court concludes the modification is not inconsistent with any material purpose of the trust. The court held that neither requirement was met here. The contingent beneficiaries never consented to these modifications and the proposed modifications were inconsistent with the original material purpose of the trust.

The circuit court also examined Section 411(e) of the ITC, which states that a court may approve a proposed modification when all the beneficiaries do not consent if the trust could have been modified and the nonconsenting beneficiary is “treated equitably and consistent with the purpose of the trust.” Once again, the circuit court concluded that the modification here did not satisfy either requirement because Grantor was trying to modify the trust in a way that eliminated the contingent beneficiaries’ beneficial interest in the trust, which was not equitable or consistent with the stated purpose of the trust.

The plain language of the trust also did not allow for Grantor’s modifications. Pursuant to the trust instrument, the trustee could modify the trust in certain tax and administrative circumstances so long as both trust protectors of the trust approved of such trust modifications. Since these

modifications were requested by Grantor and not the trustee, did not get the approval of the trust protectors and the modifications did not fall under one of the reasons in the trust document to modify the trust, Grantor could not rely on the language of the trust itself to modify the trust.

In re Estate of Hirschfeld, 2023 IL App (5th) 220630 (August 1, 2023)

In *Hirschfeld*, a father's (Father) children sought to recover assets from their father's second wife (Second Wife) by asserting claims of breach of fiduciary duty and conversion. Father and his first wife, the children's mother, divorced in 1998. Shortly thereafter, in 1999, Father and Second Wife were married. Pursuant to their prenuptial agreement, Father and Second Wife's assets were to remain separate.

In 2000, Father executed a financial power of attorney that named Second Wife as his agent. Following this, Father's mental and physical health declined, and he eventually died in 2014. During the later years of Father's life, Second Wife transferred and disposed of numerous assets of Father for her own benefit, which she authorized as Father's agent under the power of attorney.

The trial court found that since Father and Second Wife were spouses at the time of these transfers, the presumption of a gift would apply. The appellate court disagreed. Since Second Wife was named as Father's agent, she had a fiduciary relationship with Father. The court stated that "where a fiduciary relationship exists and the dominant party engages in self-dealing by facilitating a conveyance of the non-dominant party's property that benefits the dominant party, the presumption of undue influence or fraud applies despite any familial relationship between the

parties." Therefore, the appellate court held that the presumption of undue influence or fraudulent transfers applied to these transfers of Father's assets that benefited Second Wife since she facilitated and authorized these transfers as Father's agent.

New York Updates

State Estate Taxation

For individuals dying on or after January 1, 2024, the exemption amount will be equal to the federal exemption amount indexed annually, but without regard to the passage of the Tax Cuts and Jobs Act of 2017. Notary Journals and the Beginning of Remote Notarization

As of January 25, 2023, all Notary Publics registered in New York State must keep a record of all notarial acts (whether traditional or electronic) containing the following information: (i) the date the notarial act was performed; (ii) the approximate time the notarial act was performed; (iii) the type of notarial act performed (i.e., acknowledgement; oath or affirmation; affidavit or deposition; demanding acceptance of payment of foreign and inland bills of exchange, promissory notes and obligations in writing, and protesting the same for non-acceptance or non-payment, as the case may require; preparation of a certificate of authenticity; and an electronic notarial act); the name of any individuals for whom a notarial act was performed; (v) the address of any individuals for whom a notarial act was performed; (vi) the type of credential used to identify the principal; (vii) the verification procedures used by the Notary Public; and (viii) for electronic notarizations, identification of the communication technology and, if not included as part of the communication technology used, the certification authority and

verification providers used. Journal records must be kept by the Notary Public for at least 10 years and be able to be inspected by the New York State Secretary of State or its agents.

Additionally, the permanent remote online notarization (RON) regime went into effect on January 31, 2023, and is only available for documents that otherwise may be signed electronically under New York law.

There are additional requirements that have been set in place for Notary Publics using the RON regime. Any Notary Public wishing to provide RON services must complete an additional registration process with the New York Secretary of State. The remote online notarial certificate for an electronic notarial act must clearly state that the principal appeared before the Notary Public using communication technology. New York State has prescribed the following language to be included in all remote online notarial certificates: “This electronic notarial act involved a remote online appearance involving the use of communication technology.”

While Notary Publics performing notarial acts under the RON regime must be located in New York State at the time of the electronic notarization, the principal may be located anywhere in the world. However, during the electronic notarial act, the Notary Public must verbally verify that either (i) the principal is currently located in the United States or (ii) the principal is currently located outside of the United States and the record or subject of the notarial act is (a) to be filed with or relates to a matter before a public official or court, governmental entity or other entity subject to the jurisdiction of the United States or (b) involves property located in the territorial jurisdiction of the United States or involves a transaction substantially connected with the United States.

The audio and video recording of an electronic notarial act must contain (i) the completion of the notarial act, (ii) the verification of either location within the United States or connection to the United States as described above, (iii) any signatures required for completion of the notarial act and (iv) a verbal description of the type of identification used. The audio and video conference recording must be kept by the electronic Notary Public for at least ten years and be able to be inspected by the New York State Secretary of State or its agents.

There is no indication whether forums that typically require hard copy documents with wet ink signatures (e.g., Surrogate's Court) will accept documents electronically notarized under New York law. Therefore, the RON regime provides for a "papering out" process that may be completed in connection with an electronic notarial act whereby the Notary Public who performed the electronic notarization executes a paper certification (i.e., certificate of authenticity) that a tangible copy of a document is an accurate copy of the electronic record.

New York Limited Liability Company Transparency Act

In January 2023, a bill was proposed to enact the New York Limited Liability Company Transparency Act (the "NY LLC Transparency Act"), which would require limited liability companies (LLCs) operating in New York State to provide certain informational filings to the New York State Secretary of State relating to the beneficial owners of such entity. The NY LLC Transparency Act is a state corollary to the CTA, which is discussed in greater detail above in this advisory. The NY LLC Transparency Act has passed the New York State Assembly and the New York State Senate and is currently awaiting delivery to Governor Kathy Hochul.

Importantly, the full legal name and business address of each beneficial owner that is reported would be available on a publicly accessible online database. The public availability of this information under the NY LLC Transparency Act is a stark difference compared to the CTA, in which such information will not be publicly available.

If signed into law by Governor Hochul, the NY LLC Transparency Act would come into effect 365 days thereafter. Any newly formed New York LLC would be required to provide the informational filing as part of its formation, and a newly formed foreign LLC would have to provide the informational filing when applying for authorization to conduct business in New York State. All pre-existing entities would be required to file such information with New York State by January 1, 2025, or otherwise upon any amendment to the LLC's filed organizational documents.

Matter of Obus and Residency for New York State Tax Purposes

Generally, an individual is a New York State resident for tax purposes if that individual (i) maintains a permanent place of abode in New York State and (ii) is present in New York State for at least 183 days during the tax year. In a case before the Third Department's Appellate Division, *Matter of Obus v. New York State Tax Appeals Trib.*, 206 A.D.3d 1511 (3d Dep't 2022), the Court held that an individual who was domiciled in New Jersey and had a vacation home in New York State was not a New York State resident for tax purposes even though he spent more than 183 days in New York State during the tax year. The taxpayer, in this case, commuted from New Jersey to New York City for work. The taxpayer's vacation home was in Fulton County, New York and was used by the taxpayer for two to three weeks each year. Further, a tenant occupied an apartment attached to the

vacation home year-round. The taxpayer did not keep any personal effects in the vacation home, instead choosing to bring with them everything that they would need for their visits. In determining that the taxpayer was not a New York State resident for tax purposes, the court focused on the legislative intent of the law and noted that the taxpayer must have a residential interest in the property in order for the property to qualify as a permanent place of abode. Because of the aforementioned factors and the fact that the vacation home was far from his workplace in New York City, the Appellate Division held that the taxpayer did not have a residential interest in the vacation home and that, as such, the vacation home did not qualify as a permanent place of abode for the taxpayer. Therefore, the taxpayer was not a New York State resident for tax purposes for such year.

On February 9, 2023, the motion for leave to appeal was denied, rendering the Appellate Division's decision as final. The subjective facts and circumstances standard that was present in *Matter of Obus* leaves taxpayers who are looking to avoid New York State residency for tax purposes with no clear guidance. The New York State Department of Taxation and Finance has suggested that further guidance is forthcoming, and we await the issuance of such guidance.

Removal of Notary Requirement for Affidavits in Civil Matters

The New York Civil Practice Law and Rules, which affects civil proceedings in New York courts, including Surrogate's Courts, was amended to allow an affirmation by any person instead of needing a formal affidavit. Previously, only attorneys, physicians, osteopaths, dentists and persons outside of the United States had been able to submit affirmations in lieu of affidavits. This change goes into effect on January 1, 2024, and will ease the unnecessary

burdens on all litigants and non-party witnesses, wherever located, who wish to file sworn statements with the New York court system in civil matters.

Billionaire Tax

In January 2023, a bill was proposed to impose a mark-to-market tax on New York State residents with net assets worth $1 billion or more at the end of each taxable year beginning with the 2023 tax year. To calculate the tax due, gain or loss would be recognized as if each asset owned by the taxpayer were sold for its fair market value on December 31 of the previous tax year. The net gain from these deemed sales would be included in the taxpayer's income for the following year up to a phase-in maximum amount. The tax due could be paid annually for the current taxable year or in 10 equal annual installments, along with an additional charge for such deferral. For each succeeding year, a credit would be given to the taxpayer for gains previously subject to such tax. While this bill received much publicity when it was first proposed, it has since stalled in the legislature.

State-Level Capital Gains Tax

In January 2023, a bill was proposed to impose an additional state tax on long-term capital gains, dividends or any other type of capital gain income. Such tax would be imposed at a rate of 7.5 percent for married individuals filing jointly with taxable income in excess of $500,000 and 15 percent for married individuals filing jointly with taxable income in excess of $1,000,000 on such capital gain income. While this bill also received publicity when it was first proposed, it has since stalled in the legislature.

Power of Attorney Disclosure

In January 2023, a bill was proposed that would require the principal under a power of attorney to make a good faith effort to notify their co-trustees of any trust in which the principal serves as a trustee of the identity of an agent in an executed power of attorney that names an agent who is not otherwise a co-trustee of such trust, and that would affect such trust. Similarly, the bill would require the principal under a power of attorney who is a beneficiary of a trust to make a good faith effort to notify the principal's co-beneficiaries of the identity of an agent named in an executed power of attorney. The stated goal of this legislation is the protection of co-trustees and co-beneficiaries, as would be relevant, where one of such trustees or beneficiaries creates a power of attorney naming an agent to act for such trustee or beneficiary and shares an account or trust with others. The rationale is that, as a result, without any notice, the non-party agent may have the ability to raid a financial account or trust, thus taking all available funds. However, with regard to a trustee executing a power of attorney, pursuant to New York State common law, the duty of a fiduciary is personal and unable to be delegated; a fiduciary who delegates his or her fiduciary duties by way of a power of attorney is liable for breach of trust and potentially subject to discharge. In the case of co-beneficiaries of a trust, it is unclear how the agent of a beneficiary would be able to impact funds designated for other beneficiaries of the same trust. A beneficiary of a trust may ask for funds but generally has no unilateral power to withdraw funds.

A similar bill was proposed in 2022 and vetoed by Governor Hochul on December 16, 2022. The bill, as proposed in 2023, has stalled in the legislature.

North Carolina Updates

The most relevant North Carolina legislation this year relates to electronic notarization. As discussed in last year's advisory, the North Carolina Remote Electronic Notary Act (referred to as "RENA") was enacted last year on July 8, 2022. This act permanently codified remote electronic notarization (REN) and restored North Carolina's "temporary" emergency video notarization and remote video witnessing (EVN). The act initially provided that the temporary EVN laws would expire on June 30, 2023, when the REN provisions became effective. This one-year period was intended to give the NC Secretary of State time to prepare and adopt relevant rules and regulations to implement the law.

On June 23, 2023, Governor Roy Cooper enacted amendments to the Notary Act under N.C.G.S. Chapter 10B. These amendments are generally changes to RENA, as well as responses to public comments to the NC Secretary of State's Advance Notices of Proposed Rulemaking and Requests for Public Comment over the past year.

The most significant changes made by these amendments are as follows:

1. Journal Entries and Seal. The amendment confirms that journal entries or any related recording created by a notary while performing a notarial act are not public records under North Carolina's public record laws. The act also now requires that all notaries maintain a journal of all notarial acts performed. This requirement was effective upon enactment and applies to all notaries (not just electronic notaries). Additionally, the act requires the delivery of the notary's seal to the Secretary of State upon expiration of the notary commission within 45 days of expiration.

2. Extension of Emergency Video Notarization and Emergency Video Witnessing and Delay of Remote Electronic Notarization. The effective date for "permanent" REN was changed from July 1, 2023, to July 1, 2024. As a result, the "temporary" EVN rules are extended until 12:01 a.m. on June 30, 2024.

Note that there are several important differences between RENA and remote notarization and witnessing under EVN:

- EVN allows the execution of estate planning documents, but RENA specifically excludes wills and trusts.
- EVN allows for remote witnessing, but RENA does not include a provision for remote electronic witnessing that will apply after June 30, 2024. Therefore, remote video witnessing will not be allowed after 12:01 a.m. on June 30, 2024.

3. Remote Notary Authorization Changes. The amendment modifies various definitions sections to clarify that an electronic notary is a notary authorized to perform in-person electronic notarial acts as well as remote electronic notarial acts and also adds defined terms for geolocation, remotely located principal and self- attestation. The act also requires that an electronic notary must register with the Secretary of State before performing any electronic notarial act.

There are certain documents that an electronic notary is barred from notarizing. Death beneficiary forms that require acknowledgment have been removed from this list of documents. Therefore, the amended list of excluded documents is as follows:

- A self-proved will execute pursuant to Article 4A of Chapter 31 of the General Statutes.

A revocable or irrevocable trust or any other document amending the same except for a certification of trust or similar document.

A codicil to a will.

Any document related to the relinquishment of parental rights under Article 3 of Chapter 48 of the General Statutes.

Texas Updates

The Texas Legislature has been in session throughout 2023, paving the way for important legislative updates in the Lonestar State. With a historic $32.7 billion surplus, the Legislature invested heavily into education, social services, and infrastructure modernization—welcomed changes as the state's population continues to soar. Post-pandemic economic and political factors have also driven some of the nation's wealthiest families from the East and West Coasts to Texas, so tax, trust and estate, and business legislation are particularly important focuses.

Texas Homestead Exemption

As the population increases, so too does the demand for housing, resulting in fewer available homes and increased prices. Beginning January 1, 2023, the Legislature increased the available homestead exemption from $25,000 to $40,000. However, in light of the higher-than-anticipated budget surplus, the Legislature increased the available homestead exemption even further to $100,000. As home prices and interest rates continue to climb, the higher exemption amount should hopefully enhance affordability.

Relatedly, HB2196, effective June 9, 2023, clarified statutory language regarding the Texas homestead exemption as it relates to property owned by trusts. There are two distinct statutes relating to the homestead

exemption: Section 41.0021(a) of the Texas Property Code (Property Code), on the one hand, relates to the homestead exemption with respect to asset and creditor protection, while Section 11.13(j) of the Texas Tax Code (Tax Code), on the other hand, relates to the homestead tax exemption.

As a general matter, an individual's home owned by a trust may qualify for the Texas homestead exemption so long as the trust is a "qualifying trust." Prior to HB2196's effective date, however, there was a slight variance between the Property Code and Tax Code regarding the definition of "qualifying trust." One of the criteria that could make a trust a "qualifying trust" under the Property Code required that the settlor or beneficiary could use the principal residence "*at no cost* to the settlor or beneficiary, other than payment of taxes and other costs…" (emphasis added). Importantly, though, a trust is also a "qualifying trust" under the Property Code if the settlor or beneficiary of the trust has the right to revoke the trust without the consent of another person (other than a co-settlor spouse). A revocable trust, therefore, would almost always be a "qualifying trust" under the Property Code.

The Tax Code, on the other hand, defines a "qualifying trust" as one in which "the trustor of the trust or a beneficiary of the trust has the right to use and occupy as the trustor's or beneficiary's principal residence residential property rent free and without charge except for taxes and other costs…" (emphasis added). Unlike the Property Code, it does not matter whether the trust is revocable or not. Rather, the trust must provide the foregoing "*rent free and without charge*" language to be a "qualifying trust" under the Tax Code.

HB2196 revised the Property Code to more closely track the language of the Tax Code so that the Property Code now defines a "qualifying trust" as one that provides that a settlor or beneficiary of the trust has the right to "use and occupy the residential property as the settlor's or beneficiary's principal residence at no cost, *or rent free and without charge*, except for taxes and other costs…" (emphasis added). Individuals residing in homes owned by trusts should consult with counsel to ensure that such trusts are adequately drafted so as to permit continued enjoyment of the Texas homestead exemption.

Business Courts

In an effort to accommodate the rapid business growth Texas is experiencing, the legislature established special courts to oversee complex business cases. In particular, the new business courts will have jurisdiction over the following:

- Disputes over $5 million that involve various corporate affairs, such as derivative actions, actions by a business or its owner against another officer or owner, and actions to hold owners or executives responsible for breaches of duty;
- Cases involving publicly traded companies, regardless of the amount in question; and
- Cases in excess of $10 million that involve contracts or commercial transactions and where the parties consent to the business courts' jurisdiction.

Certain classes of disputes are expressly outside of the business courts' jurisdiction. For example, the business courts may not hear cases brought under the Texas Family Code, Estates Code, Insurance Code, and Title 9 of the Property Code, nor medical and legal malpractice, personal injury or

insurance coverage cases. It remains to be seen what impact, if any, the introduction of the business courts will have within the private wealth sector. For instance, many wealthy families employ private trust companies to consolidate family wealth and serve as fiduciaries of family members' trusts and estates. A lawsuit by a beneficiary of such a trust against the private trust company for breach of fiduciary duty would likely not fall within the business courts' purview, as breach of fiduciary duty claims often fall within the Texas Estates Code. However, it is conceivable that other types of disputes may arise in the private trust company context that would be within the business courts' jurisdiction, such as disputes regarding management of the private trust company or contracts entered into with third parties by the private trust company. The new business courts will be available for disputes commencing on or after September 1, 2024, at which time we expect more insight into the business courts' applicability to the private wealthy industry.

Electric Vehicle (EV) Tax

As a result of the increasing popularity of EVs, Texas has introduced a new tax to compensate for lost tax revenue. According to a report from the *Dallas Morning News*, Texas has nearly 200,000 electric vehicles in the state, with more than 30,000 new electric vehicles added to the roads in 2023 alone. Gas-car drivers incur a 20 cent per gallon tax, which funds highway maintenance costs, and it is estimated by the *Dallas Morning News* that the average Texas driver spends $130 per year in gas taxes. Therefore, more EVs mean less money for roads. In response, the Texas Legislature enacted a $400 fee to register new EVs, plus an annual $200 renewal registration fee for EV owners.

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