Wealth Management Update

June 2024

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As part of our ongoing efforts to keep wealth management professionals informed of recent developments related to our practice area, we have summarized below some items we think would be of interest. Please let us know if you have any questions.

June 2024 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split-Interest Charitable Trusts

The June Section 7520 rate for use in estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.60%, an increase from the May rate of 5.40%. The June applicable federal rate ("AFR") for use with a sale to a defective grantor trust or infra-family loan with a note having a duration of:

- 3 years of less (the short-term rate, compounded annually) is 5.12%, up from 4.97% in May.
- 3 years to 9 years (the mid-term rate, compounded annually) is 4.66%, up from 4.42% in May.
- 9 years or more (the long-term rate, compounded annually) is 4.79%, up from 4.55% in May.

U.S. Senate Targets Grantor Retained Annuity Trusts

Senators Ron Wyden (D, Oregon) and Angus King (I, Maine) introduce the Getting Rid of Abusive Trusts Act, which proposes several substantial changes to Grantor Retained Annuity Trusts ("GRATs"). Notable provisions include:

- A GRAT would be required to have a minimum term of 15 years and a maximum term of the life expectancy of the annuitant, plus 10 years.
- A GRAT would be prohibited from decreasing its annuity amount during the trust term.
- A GRAT remainder interest would be required to have a minimum value for gift tax purposes of the greater of 25% of the fair market value of assets transferred to the trust, or $500,000.
- Transfers between the deemed owner of a GRAT and the GRAT would be classified as sales or exchanges subject to income tax.
    - Limited exceptions extend to (1) revocable grantor trusts; (2) "asset-backed securities trusts," which contain mortgage-backed securities or other asset-backed securities, and is engaged in securitization transactions; or (3) any other grantor trust identified by the Secretary that may otherwise be excluded.
- Income tax paid on trust income by the deemed owner of a GRAT would be treated as a taxable gift, except when the grantor is reimbursed by the GRAT for the amount paid during the same calendar year.

IRS Issues Notice 2024-35, Providing Relief for Taxpayers Who Failed to Take RMDs

The IRS recently issued Notice 2024-35, waiving any excise tax for taxpayers who failed to take required minimum distributions ("RMDs") for the 2024 tax year for certain inherited retirement accounts subject to the 10-year rule under the SECURE Act.

Under the SECURE Act, after the death of the owner of a § 401 defined benefit plan or an IRA, and (1) the owner died on or after the beginning RMD date, and (2) the death beneficiary is not an "Eligible Beneficiary," defined as a surviving spouse, a minor child, disabled, chronically ill, or less than 10 years younger than the account owner, then the entire balance of the plan or IRA must be withdrawn by the end of the calendar year containing the 10th anniversary of the owner's death.

Many taxpayers mistakenly believed that no distributions were required on an annual basis, provided that the entire balance of the plan or IRA must be fully distributed by the end of the calendar year containing the 5th anniversary of the owner's death, aligning with the old 5-year rule, applying to those plans and IRAs for which the owner died before his or her RMDs began. Given the confusion, taxpayers subject to the new 10-year rule were not making the required annual RMDs. On February 24, 2022, the IRS issued proposed regulations clarifying that distributions must be taken annually for plans and IRAs subject to the 10-year rule.

The IRS issued Notices 2022-53 and 2023-54, extending temporary relief to taxpayers that failed to take annual RMDs from 2020 through 2023. Now, Notice 2024-35 extends the relief period through 2024, waiving the excise tax for those taxpayers subject to the 10-year rule who fail to take RMDs during the 2024 tax year. Notice 2024-35 further noted that Final regulations will be issued, effective January 1, 2025, to provide permanent clarity of the rule. Presumably, once Final Regulations are issued, the IRS will likely not issue further relief for future years.

The IRS Adopts New Reg. § 26.2642-7

The Treasury Department and IRS released final regulations regarding the circumstances and procedures under which an extension of time will be granted under section 2642(g) to make certain late allocations of Generation-Skipping Transfer ("GST") Tax exemption and elections.

This new Regulation replaces IRS Notice 2001-50, which had previously served as the main source of guidance for taxpayers seeking relief for an extension of time to allocate GST exemption or to (i) elect out of automatic allocation to a direct skip, (ii) elect out of automatic allocation to an indirect skip, and (iii) elect to treat any trust as a GST trust.

Under Notice 2001-50, relief would generally be granted if the taxpayer satisfied the requirements of the regulations and established, to the IRS's satisfaction, that the taxpayer acted reasonably and in good faith and that a grant of relief wouldn't prejudice the government's interests. The IRS and Treasury provided no substantive clarity as to how these requirements could be satisfied.

New Reg. § 26.2642-7, originally proposed in 2008, identifies specific standards that the IRS will apply when determining whether to grant the requested relief and procedural requirements for establishing eligibility for the requested relief. Reg. § 26.2642-7, include the following provisions:

- The amount of GST exemption that may be allocated cannot exceed the amount of the transferor's unused GST exemption that existed at the time of the transfer.
- Factors that the IRS will consider in determining reasonableness and good faith include but are not limited to: (i) the intent of the transferor; (ii) intervening events beyond the control of the transferor; (iii) lack of awareness, despite exercise of reasonable diligence; (iv) consistency with regard to prior transactions; and (v) reasonable reliance on the advice of qualified tax professional.
- Factors that the IRS will consider in determining lack of prejudice to the interests of the government include, but are not limited to: (i) whether the taxpayer is attempting to benefit from hindsight, or more specifically, whether the relief would permit an economic advantage or other benefit that would not have been available at the time of the transfer; (ii) whether the timing of the relief request was delayed to deprive the IRS of a sufficient period of time to challenge an element of the transfer; and (iii) whether there was an intervening taxable termination or distribution in between the transfer and the relief request.
- Taxpayers now have an automatic 6-month extension from the due date of the gift or estate tax return to make the late allocation or election on a supplemental return, provided that the taxpayer timely filed an original return. After the expiration of this 6-month period, a Private Letter Ruling is the exclusive remedy to seek relief.
- Relief may be granted to revoke an election under Internal Revenue Code § 2632(b)(3), to elect out of automatic allocation of GST tax exemption to direct skip, or § 2632(c)(5), to elect out of automatic allocation of GST tax exemption to GST Trust. Affirmative elections or

allocations are irrevocable, subject to three narrow exceptions.

- A request for relief does not reopen, suspend, or extend the period of limitations on the assessment or collection of any estate, gift, or GST tax. While the IRS may request that the taxpayer consent to extend the period of limitations to assess or collect gift and GST tax, the taxpayer is not required to agree. While the IRS has noted that a refusal would not necessarily result in the denial of relief, refusal would still be a factor that may be considered when determining whether the government's interests would be prejudiced.
- The taxpayer must still submit detailed explanatory affidavits from the taxpayer and other parties, such as tax professionals.

Finkbeiner, PLC v. Estate of Scott, No. 363756, 2024 BL 112514 (Mich. Ct. App. Mar 21, 2024)

The Michigan Court of Appeals ruled against a law firm seeking attorney's fees for services incurred in representing a personal representative and trustee who engaged in bad faith conduct due to undue influence on a decedent who lacked testamentary capacity.

Matthew G. Scott died on July 30, 2020, survived by two sons. One son, Christopher, petitioned the probate court to set aside Matthew's will, trust, and other estate planning documents after learning that Matthew had appointed Phillip Sprague as personal representative and trustee.

Matthew suffered myriad ailments towards the end of his life, seeking treatment at Mayo Clinic, where he had stayed with Christopher. After suffering a traumatic brain injury, Matthew's family moved him to an assisted living facility. While Matthew initially seemed to enjoy his living arrangement, his demeanor began to change after becoming re-acquainted with Sprague, a former employee. Over time, Matthew began to exhibit paranoia, aggression, and anger, which the facility staff attributed to Sprague's own open hostility towards the facility and Matthew's family. Sprague then moved Matthew to Sprague's own home, where Matthew remained, isolated from family, until he died.

During this time, Sprague brought Matthew to an attorney to update Matthew's estate planning documents. At the meetings, Matthew showed obvious signs of his lack of capacity; namely, he could not recall present or historical facts about his life and estate, respond without the attorney asking leading questions, or stay focused. Despite these signs, and the fact that Sprague arranged the meetings and accompanied Matthew, the attorney drafted and executed new estate planning documents with Matthew. After Matthew's death, Sprague's attorneys represented him in his fiduciary capacity in Matthew's estate and trust, which included actions such as recovering an investment account and administering Matthew's estate.

Christopher alleged that Matthew's documents were invalid because Matthew lacked capacity to create them and that Sprague unduly influenced Matthew to create them. At trial, the jury found for Christopher, removed Sprague, and appointed Christopher in Sprague's place. The decision was affirmed on appeal.

The law firm sought payment of its fees by the estate, and not Sprague, because such fees incurred from representing the fiduciary of an estate are payable by the estate under Michigan statute MCL 700.3720. The estate argued, in response, that such fees were not recoverable because Sprague had not acted in good faith in light of his unduly influencing Matthew, who needed greater capacity to make the changes to his estate plan. The probate court ruled in favor of the estate.

The Michigan Court of Appeals found that a finding of lack of capacity and undue influence equate to a lack of good faith for purposes of the statute. Because the lower court made such findings in this case, Sprague could not have acted in good faith in engaging in his fiduciary capacity. This behavior ran afoul of the pain test of the statute, and the court accordingly affirmed the lower court's judgment in favor of the estate, denying payment.

New Challenges to the CTA Argue Alternative Theories for the Law's Unconstitutionality

In two recently filed cases, parties asserted new constitutional challenges against the Corporate Transparency Act (the "CTA") beyond those discussed in *Nat'l Small Bus. United v. Yellen*, the Alabama case ruling that the CTA is unconstitutional because it exceeds Congress's enumerated powers, but only applying to the parties to the litigation.

The CTA, passed in 2021 to curb illicit finance, requires many entities conducting business within the United States to report ownership and control information to a federal database. Existing companies created before January 1, 2024, must report such information by January 1, 2025, and any new company created on or after January 1, 2024, must report such information within 90 days of formation. A violation of the CTA could result in criminal penalties.

On March 1, 2024, the Alabama court found that the CTA exceeds Congress's powers over foreign affairs and national security, under the Constitution's Commerce Clause, and under its taxation authority. The court did not address any further constitutional arguments, namely that it violates the First, Fourth and Fifth Amendments. Now, two new cases have been filed with similar allegations, which threaten the CTA's constitutional status on a broader scale.

The plaintiff in *Small Business Association of Michigan et al v. Yellen et al*, Docket No. 1:24-cv-00314 (W.D. Mich. Mar 26, 2024) alleges that the CTA amounts to (1) an unconstitutional regulation in excess of Congress's enumerated powers because Congress has no authority over mere corporate formation; (2) an unreasonable search and seizure in violation of the Fourth Amendment because the law violates the reasonable expectations of privacy without a warrant, reasonable suspicion, court oversight, or review by a neutral third party; and (3) an unconstitutional violation of due process due to vagueness in violation of the Fifth Amendment because the law fails to specifically define terms like "beneficial owner," "understanding," "relationship," "otherwise," and "substantial control," such that businesses cannot understand what is required to avoid criminal sanctions.

The plaintiff in *Boyle v. Yellen et al*, Docket No. 2:24-cv-00081 (D. Me. Mar 15, 2024) argues that the CTA amount to an unconstitutional usurpation of the states' power to regulate entity formation in excess of Congress's enumerated powers under Article 1 and Congress's reserved powers under the Ninth and Tenth Amendments.

Regardless of the eventual outcome of these cases, the issue is sure to ascend to the appellate stage, with most commentators believing the U.S. Supreme Court will eventually rule on the matter, providing national clarity.

U.S. House of Representatives Passes Bipartisan H.R. 6408, Suspending the Tax-Exempt Status of Terrorist Supporting Organizations

Section 501(p) of the Internal Revenue Code currently prohibits tax-exempt status for terrorist organizations. After overwhelming bipartisan support as part of the recent foreign aid package for Israel, Ukraine and Taiwan, the House of Representatives voted 382-11 to pass a new bill that would expand the prohibition of tax-exempt status to "terrorist supporting organizations," defined as those providing "material support or resources" to a terrorist organization "in excess of a de minimus amount."

Under Section 501, an organization may be designated a terrorist organization either via executive order or under the Immigration and Nationality Act. The new bill gives the Treasury Secretary authority to designate "terrorist supporting organizations" after written notice that specifies important information, such as the name of the organization that is being supported and a description of the support given. Once identified by the Treasury, such "terrorist supporting organization" has 90 days to refute the designation. Alternatively, it can regain tax-exempt status by showing that it has made efforts to have resources returned and certifying that it will not provide further support.

The Private Client Services Department at Proskauer is one of the largest private wealth management teams in the country and works with high-net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

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