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Estate Planning Insights

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Some Recent Tax and Legal Items to Note

NOTICE 2024-35: IRS CONTINUES TO DELAY IMPLEMENTATION OF A CERTAIN RMD RULE APPLICABLE TO DBS. The SECURE Act, passed in late December 2019 and effective January 2020, made significant changes to the "RMD Rules"—i.e., the income tax rules applicable to distributions from qualified employee benefit plans (such as 401(k) plans and profit-sharing plans) and IRAs (each individually referred to as a "retirement plan"). These new rules affect "Participants" (employees and retirees who participate in qualified employee benefit plans and named owners of IRAs) and beneficiaries of Participants who inherit the Participant's retirement plan on his/her death.

A major change per the SECURE Act was to require certain beneficiaries who inherit a retirement plan on the Participant's death to withdraw 100% from the inherited retirement plan by December 31 of the year containing the 10th anniversary of the Participant's death. (That change eliminated the so-called "stretch IRA" that those particular beneficiaries enjoyed under prior law.) That new distribution rule is referred to as the "10 Year Rule." The 10 Year Rule applies to each beneficiary who is a "Designated Beneficiary" ("DB") but *not* an "Eligible Designated Beneficiary" ("EDB"). An example of a DB would be an adult child of the Participant who is not disabled or chronically ill. Briefly, the 5 EDBs are (i) the Participant's Spouse, (ii) the Participant's child under age 21, (iii) a disabled individual, (iv) a chronically ill individual, and (v) an individual not more than 10 years younger than the Participant. (*See* our prior newsletters discussing the SECURE Act for further information: www.gerstnerlaw.com.)

Initially, nearly everyone assumed the new 10 Year Rule would be applied like the longstanding "5 Year Rule," which, if true, would mean that the DB would not be required to take any distributions from the inherited retirement plan during years 1 through 9 after the Participant's death, but would just have to withdraw 100% from the inherited retirement plan by December 31 of the year containing the 10th anniversary of the Participant's death. That interpretation appeared to be consistent with Congressional intent. However, when the proposed regulations to the SECURE Act (the "Proposed Regulations") were published in February 2022, it became clear that the IRS's position is that there are basically two different 10 Year Rules, depending on whether the Participant dies before *or* on or after ("after") his/her "required beginning date" ("RBD"). RBD was age 70½ through 12/31/2019 (prior to the SECURE Act), then age 72 through 12/31/2022, and now age 73 (until 2033, when it becomes age 75). If the Participant dies *before* reaching his/her RBD, the new 10 Year Rule applicable in that case *is* applied like the 5 Year Rule—the DB is not required to take any distributions until December 31 of the year that contains the 10th anniversary of the Participant's death, at which time the DB must withdraw the full amount in the inherited retirement plan. However, if the Participant dies *after* his/her RBD, the DB must

take a "required minimum distribution ("RMD") during years 1 through 9 of the years following the year of the Participant's death *and* must withdraw the full amount remaining in the inherited retirement plan by December 31 of the year containing the 10th anniversary of the Participant's death. Of course, a DB can always withdraw *more* than the RMD. However, withdrawing *less* than the RMD, including failing to withdraw the full amount from the inherited retirement plan at the end of the period of the 10 Year Rule, results in a penalty.

Prior to passage of SECURE 2.0 in December 2022, the under-distribution penalty was a whopping 50%. However, SECURE 2.0 dropped the penalty to 25% and even 10% in certain cases. Further, it may still be possible to obtain a complete waiver of the penalty based on certain "good facts."
Nevertheless, it's always a good idea to avoid taking an action (or failing to take an action) that triggers a tax penalty.

As noted, the SECURE Act became effective on January 1, 2020, but the Proposed Regulations were not published until February 2022. By the time the Proposed Regulations were published, many DBs who had inherited retirement plans *from Participants who died on or after January 1, 2020 and after their RBD,* had already failed to take RMDs in 2021 and were at risk of failing to take RMDs in 2022. Thus, the IRS published Notice 2022-53, which eliminated the penalty for the failure of a DB in this situation to take his/her RMD in years 2021 and 2022 (as applicable). Subsequently, the IRS published Notice 2023-54, which eliminated the penalty for the failure of a DB in this situation to take RMDs in 2023. On April 16, 2024, the IRS published Notice 2024-35, which eliminates the penalty for the failure of a DB in this situation to take his/her RMD in 2024. (There are other situations covered by these notices, which we will not discuss in this newsletter.) The main point is that the IRS is delaying "full implementation" of this particular RMD rule until January 1, 2025, at the earliest.

NOTE 1: None of the IRS Notices discussed above indicate that this particular RMD rule does not apply in the case where (i) a Participant who dies on or after January 1, 2020, dies after his/her RBD and (ii) the Participant's beneficiary is a DB. The IRS is merely saying that no penalties will be imposed on DBs for failing to take RMDs pursuant to this rule during years 2021, 2022, 2023, and 2024.

NOTE 2: While Roth IRAs *are* subject to the RMD Rules and the 10 Year Rule *does* apply to DBs who inherit Roth IRAs, a living Participant of a Roth IRA does not have an RBD. That means a living Participant of a Roth IRA is always deemed to have died before reaching his/her RBD. Therefore, a DB who inherits the Participant's Roth IRA does not have to take RMDs in years 1 through 9 of the years following the year of the Participant's death—that DB just has the requirement of withdrawing the full amount of the inherited Roth IRA by December 31 of the year that contains the 10th anniversary of the Roth IRA Participant's death.

NOTE 3: A completely different rule applies when the Participant's beneficiary is an EDB. In that case, with an exception for the case in which the Participant dies before his/her RBD and the Participant's spouse makes the Section 327 election per SECURE 2.0 (*see* Note 4), the EDB must generally begin taking RMDs by December 31 of the year following the year of the Participant's death, *whether the Participant dies before or after his/her RBD*. Despite the changes made to the RMD Rules by the SECURE Act, EDBs are still entitled to some sort of life expectancy distribution (although not exactly the same type of life expectancy distribution for all types of EDBs). So keep in mind that the distribution rules applicable to EDBs are quite different from the distribution rules applicable to DBs.

NOTE 4: We originally included a discussion of Section 327 of SECURE 2.0 in this newsletter, but some "advance readers" of this newsletter felt that discussion was "too complex" to include. We might include that discussion in a future newsletter or make that discussion available upon request.

RECENT GIFT TAX DECISION. We have discussed the federal gift tax in prior newsletters and will discuss that tax in more detail in a future newsletter, but wanted to report on a recent case involving certain facts that are not unusual. On April 1, 2024, the Ninth Circuit affirmed a Tax Court decision holding that a mother's loans to her son became gifts when she realized that he could not repay them. *Estate of Bolles v. Comm'r.* The Court in *Bolles* did characterize some of the early "advances" the mother made to her son as loans. However, when it became clear that the son could not repay any of those amounts and the mother made additional "advances" to her son, all of those additional advances were treated as gifts.

If you make a loan to a child (or other family member) and you do not want that loan to be treated as a gift by you, you should observe certain "best practices." (This is going to be a very simplified and brief discussion, without getting into the OID rules and other technical issues.) The loan should be documented, in writing. Usually, that means that the borrower signs a written promissory note, containing all relevant terms, including (but not limited to), the date of the loan, the name and address of the lender, the place for payment, the amount of the loan, the maturity date, the interest rate, the payment terms, identification of the security for the loan (if any), etc. To avoid adverse tax consequences, the interest rate on the note should be at least equal to the "Applicable Federal Rate" ("AFR"). The AFR changes each month based on certain economic factors. The AFR depends on the term of the note. If the borrower clearly does not have the wherewithal to repay the loan according to its terms, then, regardless of the documentation, the loan may actually be treated as a gift, as in the *Bolles* case.

REMINDER: REQUIRED FILING PURSUANT TO THE CORPORATE TRANSPARENCY ACT! As a reminder (we have mentioned this before), beginning on January 1, 2024, the Corporate Transparency Act ("CTA") requires a "Reporting Company" (sometimes referred to as an "entity") to disclose to the Financial Crimes Enforcement Network (FinCEN), a division of the US Treasury Department, certain information about the entity, the entity's "Beneficial Owners" and, in certain cases, the entity's "Company Applicants." In terms of the deadline for filing such reports, there is a difference between an entity that was already in existence prior to January 1, 2024, and a new entity that is formed on or after January 1, 2024. An entity that was in existence before January 1, 2024, must file its initial report by December 31, 2024. A new entity formed on or after January 1, 2024 and before January 1, 2025, must file its initial report within 90 days of formation. A new entity formed on or after January 1, 2025 will have 30 days to file its initial report.

A "Reporting Company" is an entity that is subject to the reporting requirements of the CTA. A Reporting Company will include the following *types* of entities (although certain entities of these types are excluded from reporting because they are "exempt"—discussed below): (i) corporations (both C corporations and S corporations, including professional corporations [PCs]), (ii) limited liability companies (LLCs) and professional limited liability companies (PLLCs), (iii) limited partnerships (LPs) and limited liability partnerships (LLPs), and (iv) business trusts (such as "Massachusetts Business Trusts"). Personal trusts are excluded from the definition of a *Reporting Company*, but trustees and beneficiaries of trusts can be *Beneficial Owners*, depending on the facts (*see* below).

For the most part, entities that are excluded from the definition of a *Reporting Company* include (but are not limited to) the following: large US operating companies, publicly traded companies, domestic governmental authorities, banks, credit unions, depository institutions, trust companies, broker-dealers, securities and commodities exchanges, registered investment advisors, public utilities, Sarbanes-Oxley registered public accounting firms, charitable organizations and charitable "split interest trusts" (such as charitable remainder trusts and charitable lead trusts). The reason for most of the above exclusions is that these types of entities are already subject to significant reporting requirements.

An important exemption is the exemption for a "large US operating company." To qualify as a "large US operating company," the particular entity must have (i) 20 or more full time employees in the US, (ii) gross receipts or sales as reported in a federal income tax return of over $5 million, and (iii) an operating presence at a physical office within the US.

The information that a Reporting Company must report includes the following: (i) the entity's name as well as any trade names and *dba* names; (ii) the entity's street address (not a P.O. Box); (iii) the jurisdiction in which the entity was formed; and (iv) the taxpayer identification number of the entity. If there is a change in any of that information, the Reporting Company must timely file an updated report.

As noted, information must also be reported regarding the entity's "Beneficial Owners." A Beneficial Owner is an individual who, directly or indirectly, through any contract, arrangement or understanding, exercises substantial control over the entity or owns or controls at least a 25% ownership interest in the entity. Ownership interests include equity, capital and/or profits interests. Based on regulations, it appears that the trustee, settlor or beneficiary of a trust can be a Beneficial Owner.

The information that must be provided in regard to each "Beneficial Owner" of the entity includes the following: (i) full legal name; (ii) date of birth; (iii) current residence address; (iv) an identification number (such as a driver's license number or passport number); and (v) a digital copy of the document showing the identification number.

For each new entity formed on or after January 1, 2024 (but not for entities in existence prior to that date), a Reporting Company must also disclose information regarding the "Company Applicant." The Company Applicant is the individual who is responsible for the creation of a reporting company through the filing of formation documents and the individual who directly submits the formation documents. In Texas, such formation documents would be filed with the Texas Secretary of State's office. With respect to each Company Applicant, the following information must be provided: (i) full legal name; (ii) date of birth; (iii) current residence address; (iv) an identification number (such as a driver's license number or passport number); and (v) a digital copy of the document showing the identification number.

Now here is the scary thing about the CTA: The penalties (i) for failure to file the required initial report by the due date, (ii) for failure to file a completely accurate report, (iii) for failure to correct an inaccurate report in a timely manner, (iv) for failure to file an updated report in a timely manner when reportable information changes, and (v) for failure to timely file a report when an entity loses its exemption (and other reporting failures) are severe: (i) $500 per day as a civil penalty (with no dollar cap) and (ii) $10,000 and/or imprisonment up to 2 years as a criminal penalty. It is possible that both penalties could apply to the same reporting failure. In addition, an entity can only make the required filing electronically (no paper filing).

Many attorneys and accountants will not file these reports on behalf of their clients (many of their professional liability insurance carriers have advised them they are not covered if they do such work). An attorney or accountant who takes on a client's required filing responsibilities could be subject to significant penalties due to clients not providing them with complete and accurate information on a timely basis. Clients do not always provide completely accurate information to their attorney or accountant, initially, and, more often than that, fail to provide their attorney or accountant, promptly, with changes to that initial information. All of that information must be timely reported to FinCEN to avoid penalties.

Karen S. Gerstner & Associates, P.C., is **not** assuming responsibility for filing any reports with FinCEN on behalf of any of our clients.

Below are three companies that will do this type of filing for a fee:

1. Corporate Transparency Act | CSC (cscglobal.com)<https://www.cscglobal.com/service/corporate-filings/corporate-transparency-act/>

For a reasonable additional fee, CSC will undertake to gather the info from each beneficial owner for the filing.

2. Corporate Transparency Act Resources | Cogency Global Corporate Business Services<https://www.cogencyglobal.com/corporate-transparency-act-resources>

3. Corporate Transparency Act Resources from CT Corporation | Wolters Kluwer<https://www.wolterskluwer.com/en/solutions/ct-corporation/resources/corporate-transparency-act-resources>

CONCLUSION. In this newsletter, we have tried to provide some information regarding current tax and legal matters that might be helpful to you. In future newsletters, we are planning to discuss (i) the significant disruption to our clients' estate plans caused by including a "Transfer on Death" (TOD) arrangement on all brokerage and investment accounts and/or including a "right of survivorship" on all bank, brokerage and investment accounts, and (ii) a discussion of certain "second level" estate planning techniques (SLATs, IDGTs, QPRTs, etc.) that many high net worth clients are already using due to the upcoming drop in the estate tax exemption.

Contact us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone (713-520-5205), fax (713-520-5235) or email sent to:

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