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PRIVATE WEALTH ADVISORY

2020 Year-End Estate Planning Advisory

November 24, 2020

Overview

In 2020, COVID-19, the US presidential election, the Tax Cuts and Jobs Act (the TCJA), and the Coronavirus Aid, Relief and Economic Security Act (the CARES ACT) dominated the planning landscape.

As outlined in our 2018 and 2019 Year-End Estate Planning Advisories, the TCJA made significant changes to individual and corporate income taxes, restructured international tax rules, provided a deduction for pass-through income and eliminated many itemized deductions. Most significantly for estate planning purposes, the TCJA temporarily doubled the estate, gift and generation-skipping transfer (GST) tax exemptions. Absent legislative action, which may or may not occur during a Biden presidency (discussed below), many of the changes imposed under the TCJA — including the increased exemptions — will sunset after December 31, 2025, with the laws currently scheduled to revert back to those that existed prior to the TCJA. Given the uncertain political landscape, practitioners continue to view this temporary increase in exemption amounts as an unprecedented opportunity for valuable estate planning.

While the permanency of the TCJA's provisions still remains uncertain, the current environment provides a great deal of opportunity for new planning. We are encouraging clients to build flexibility into their estate plans and to use this window of opportunity, where appropriate, to engage in planning to take advantage of the increased estate, gift and GST tax exemptions.

The following are some key income and transfer tax exemption and rate changes under the TCJA, including inflation adjusted amounts for 2020 and 2021:

Federal Estate, GST and Gift Tax Rates

For 2020, the estate, gift and GST applicable exclusion amounts are $11.58 million. The maximum rate for estate, gift and GST taxes is 40 percent. For 2021, the estate, gift and GST applicable exclusion amounts will be $11.7 million. Absent any change by Congress, the maximum rate for estate, gift and GST taxes will remain at 40 percent.

Annual Gift Tax Exemption

Each year individuals are entitled to make gifts using the "Annual Exclusion Amount" without incurring gift tax or using any of their lifetime applicable exclusion amount against estate and gift tax. The Annual Exclusion Amount is $15,000 per donee in 2020. Thus, this year a married couple together can gift $30,000 to each donee without gift tax consequences. In 2021, the annual exclusion for gifts will remain at $15,000. The limitation on tax-free annual gifts made to noncitizen spouses will increase from $157,000 in 2020 to $159,000 in 2021.

Federal Income Tax Rates

- The TCJA provides for seven (7) individual income tax brackets, with a maximum rate of 37 percent. The 37 percent tax rate will affect single taxpayers whose income exceeds $518,400 (indexed for inflation, and $523,600 in 2021) and married taxpayers filing jointly whose income exceeds $622,050 (indexed for inflation and $628,300 in 2021). Estates and trusts will reach the maximum rate with taxable income of more than $12,950 (indexed for inflation, and $13,050 in 2021).
- A 0 percent capital gains rate applies for single filers with income up to $40,000 (indexed for inflation, and $40,400 for 2021) or married taxpayers filing jointly with income up to $80,000 (indexed for inflation, and $80,800 in 2021). A 15 percent capital gains rate applies for income above this threshold up to $441,450 for single taxpayers (indexed for inflation, and $445,850 in 2021) and $496,600 for married taxpayers filing jointly (indexed for inflation, and $501,600 in 2021). The 20 percent capital gains rate applies above these thresholds.
- The standard deduction was increased to $24,800 (indexed for inflation, and $25,100 in 2021) for married individuals.
- In 2020, the threshold for the imposition of the 3.8 percent Medicare surtax on investment income and 0.9 percent Medicare surtax on earned income is $200,000 for single filers, $250,000 for married filers filing jointly and $12,950 for trusts and estates (indexed for inflation, and $13,050 in 2021).

Tax Cuts and Jobs Act

The TCJA has proven to have many implications for domestic corporate and individual income tax, as well as Federal gift, estate and 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 guidance from the IRS, it is important to review existing estate plans, consider future planning to take advantage of the increased exemption amounts, and maintain flexibility to allow for future strategic planning. Because of the continued importance of the TCJA's new tax laws, the most significant changes and recent guidance are summarized below.

Gift, Estate and GST Exemptions, Rates and Stepped-Up Basis

The TCJA retained the Federal estate, gift and GST tax rates at a top rate of 40 percent, as well as the marked-to-market income tax basis for assets includible in a decedent's taxable estate at death.

While the Federal gift, estate and GST taxes were not repealed by the TCJA, fewer taxpayers will be subject to these transfer taxes due to the TCJA's increase of the related exemption amounts. Under the TCJA, the base Federal gift, estate and GST tax exemptions doubled from $5 million per person to $10 million per person, indexed for inflation. As noted above, the relevant exemption amount for 2020 is $11.58 million per person, resulting in a married couple's ability to pass $23.16 million worth of assets free of Federal estate, gift and GST taxes. These amounts will increase each year until the end of 2025, with inflation adjustments to be determined by the chained Consumer Price Index (CPI) (which will lead to smaller increases in the relevant exemption amounts in future years than would have resulted from the previously used traditional CPI). The exemption amount in 2021 will be $11.7 million. Without further legislative action, the increased exemption amounts will sunset, and the prior exemption amounts (indexed for inflation, using the chained CPI figure) will be restored beginning in 2026.

While the Federal estate tax exemption amount has increased, note that multiple US states impose a state level estate or inheritance tax. The estate tax exemption amount in some of these states matches, or will match, the increased Federal estate tax exemption amount. However, in other states, such as Illinois and New York, the state estate tax exemption amount will not increase with the Federal estate tax exemption amount, absent a change in relevant state law. Additionally, states may have their own laws that impact planning in that state.

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).

"Anti-Clawback" Regulations

While there is uncertainty about whether future legislation will address the sunset, either by extending the new exemption amounts beyond 2025 or changing the exemption amounts further, the IRS has issued guidance on how the Service will address differences between the exemption amounts at the date of a gift and exemption amounts at the date of a taxpayer's death (often referred to as a "clawback"). In Proposed Regulations REG-106706-18, the IRS clarified that a taxpayer who takes advantage of the current lifetime gift tax exemption will not be penalized, if the exemption amount is lower at the taxpayer's death. If a taxpayer dies on or after January 1, 2026, having used more than the statutory $5 million basic exclusion (indexed for inflation) but less than the $10 million basic exclusion (indexed for inflation), the taxpayer will be allowed a basic exclusion equal to the amount of the basic exclusion the taxpayer had used. However, any exemption unused during a period of higher basic exclusion amounts will not be allowed as an additional basic exclusion upon death. Additionally, the Service clarified that if a taxpayer exhausted his or her basic exclusion amount with pre-2018 gifts and paid gift tax, then made additional gifts or died during a period of high basic exclusion amounts, the higher exclusion will not be reduced by a prior gift on which gift tax was paid.

The Regulations do not permit gifts made during the period that the basic exclusion amount is $10 million (indexed for inflation) to "come off the top" of the higher basic exclusion amount. For example, if a taxpayer who has never made a taxable gift makes a gift of $5 million, and then dies after the basic exclusion amount has decreased back to $5 million, the gift will not be deemed to use the "extra" (indexed) $5 million of basic exclusion amount available until 2026. Instead, the gift would be deemed to use the taxpayer's $5 million basic exclusion amount. The Service could have provided that any gifts prior to 2026 come "off the top" of the $10 million exclusion amount. In that case, a taxpayer who made a $5 million gift when the basic exclusion amount is $10 million would still have retained all of the taxpayer's $5 million exclusion amount after the basic exclusion amount is reduced to $5 million in 2026. Additionally, the Proposed Regulations did not address how the reduction in the basic exclusion amount would affect portability of estate tax upon the death of a spouse.

Income Taxation of Trusts and Estates

The TCJA added new Code Section 67(g), which applies to trusts and estates, as well as individuals and provides that no miscellaneous itemized deductions (all deductions other than those specifically listed in Code Section 67(b)) are available until the TCJA sunsets after December 31, 2025. While the TCJA doubled the standard deduction for individuals, taxpayers that are trusts and estates are not provided a standard deduction. Under the TCJA, trust investment management fees are no longer deductible. After the enactment of the TCJA, there was uncertainty about the deductibility of fees directly related to the administration of a trust or estate (*e.g.*, fiduciary compensation, legal fees, appraisals, accountings, etc.). Historically, these fees had been deductible under Code Section 67(e) and without regard to whether they were miscellaneous itemized deductions or not. In Notice 2018-61, the Treasury Department (Treasury) issued guidance on whether new Code Section 67(g) eliminates these deductions. This Notice provides that expenses under Code Section 67(e) are not itemized deductions and therefore are not suspended under new Code Section 67(g). Note that only expenses incurred solely because the property is held in an estate or trust will be deductible. While the Notice was effective July 13, 2018, estates and non-grantor trusts may rely on its guidance for the entire taxable year beginning after December 31, 2017.

New Code Section 67(g) may also impact a beneficiary's ability to deduct excess deductions or losses of an estate or trust upon termination. Prior to the TCJA, it was common tax planning to carry out unused deductions of a trust or estate to the beneficiary upon termination, so the deductions could be used on the beneficiary's personal income

tax return. Under new Code Section 67(g), these deductions are miscellaneous itemized deductions and therefore would no longer be deductible by the beneficiary. Notice 2018-61 notes that the IRS and Treasury recognize that Section 67(g) may impact a beneficiary's ability to deduct unused deductions upon the termination of a trust or an estate, and the IRS and Treasury intend to issue regulations in this area and request comments on this issue. In the interim, taxpayers should consult with their advisors about whether it would be prudent to engage in planning to utilize (to the extent permissible) these deductions at the trust or estate level.

Finally, the TCJA made a number of taxpayer-friendly changes to the taxation of electing small business trusts (ESBTs). Non-resident aliens are now permissible potential beneficiaries of ESBTs, as discussed below. Also, the charitable deduction rules for ESBTs are now governed by Code Section 170 instead of Code Section 642(c), which means that several restrictions imposed by Code Section 642(c) (*e.g.*, that the charitable donation be paid out of income and pursuant to the terms of the trust) no longer apply. Additionally, an ESBT's excess charitable deductions can now be carried forward five years, but the percentage limitations and substantiation requirements will now apply.

Income Tax

The TCJA made significant changes to the federal income tax. While many federal income tax changes under the TCJA are beyond the scope of this Advisory, some are particularly relevant to estate planning. The deduction for state and local taxes (the SALT deduction) was retained but is now limited to $10,000 for jointly filing taxpayers or unmarried taxpayers. The $10,000 limit also applies to trusts. Almost immediately after the TCJA's passage, a number of states implemented workarounds to the SALT deduction limit by allowing residents to "contribute" to state-controlled charitable funds in exchange for SALT credits. The aim of these workarounds was to allow residents to characterize such contributions as fully-deductible charitable contributions for federal income tax purposes, while simultaneously permitting a credit for state or local income, real estate or other taxes for the same contribution. In the final regulations issued in August 2018 and published on June 13, 2019, the IRS responded to these workarounds by limiting federal income tax deductions that taxpayers, including trusts or estates, are able to take upon charitable contributions to such state-controlled charitable funds under Section 170 of the Code.

Under these regulations, a taxpayer who makes payments or transfers property to an entity eligible to receive tax deductible contributions would have to reduce the taxpayer's charitable deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive. Therefore, a tax credit received in return for the contribution is treated as a quid pro quo benefit for the contribution, reducing the amount of the charitable income tax deduction otherwise available dollar-for-dollar. However, there is a de minimis exception — if the amount of the SALT credit does not exceed 15 percent of the amount of the contribution, the taxpayer's charitable income tax deduction is not required to be reduced.

In response to inquiries about how these rules would apply to businesses making charitable contributions, Rev. Proc. 2019-12 was issued to provide safe harbors for C corporations and pass-through entities that make charitable contributions, receive a state and local tax credit, and deduct the payments as a business expense. Under the Revenue Procedure, C corporations may deduct the entire payment as a business expense, even if the corporation receives a state tax credit. Pass-through entities may deduct the payment as a business expense if the credit offsets a state or local tax other than an income tax (for example, franchise tax or property tax).

The TCJA also has implications for married couples who are divorcing or contemplating a divorce. The TCJA changed prior law to provide that alimony payments will not be deductible by the payor and will not be deemed to be income to the recipient. The TCJA also repealed Code Section 682, which generally provided that if a taxpayer created a grantor trust for the benefit of his or her spouse, the trust income would not be taxed as a grantor trust as to the grantor-spouse after divorce to the extent of any fiduciary accounting income the recipient-spouse is entitled to receive. Due to the repeal of Section 682, a former spouse's beneficial interest in a trust may cause the trust to

be taxed as a grantor trust as to the grantor-spouse even after divorce. These changes to the taxation of alimony and the repeal of Code Section 682 do not sunset after 2025; they apply to any divorce or separation instrument executed after December 31, 2018, or any divorce or separation instrument executed before that date but later modified, if the modification expressly provides that changes made by the TCJA should apply to the modification.

Charitable Deduction

The TCJA increases the percentage limitation on cash contributions to public charities from 50 percent of the donor's contribution base (generally, the donor's adjusted gross income) to 60 percent. This 60 percent limitation applies if only cash gifts are made to public charities. The deduction limitations remain the same for donations of other assets, such as stock, real estate, and tangible property.

Business Entities

The TCJA reduced the top corporate income tax rate to 21 percent. To decrease the discrepancy in the tax rates between C corporations and pass-through entities, the TCJA also addressed taxation of pass-through entities (partnerships, limited liability companies, S corporations or sole proprietorships) that would typically be taxed at the rate of the individual owners. Generally, new Section 199A provides a deduction for the individual owner of 20 percent of the owner's qualified business income (QBI). This deduction has the effect of reducing the effective income tax rate for an owner in the highest tax bracket from 37 percent to 29.6 percent. The deduction is subject to numerous limitations and exceptions. Notably, the deduction may be limited for taxpayers over a certain taxable income threshold ($326,000 for married taxpayers filing jointly, and $163,300 for other taxpayers, to be adjusted for inflation in future years). For these taxpayers, the deduction may be subject to limitations based on whether the entity is a "specified service business" (an SSTB, which is generally a trade or business involving the performance of services in health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading, or where the principal asset is the reputation or skill of one or more employees), the W-2 wages paid by the business entity, and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business. The IRS issued Final Regulations on Section 199A on January 18, 2019, followed by a slightly corrected version on February 1, 2019. The IRS also issued Rev. Proc. 2019-11 providing guidance on calculating W-2 wages for the purposes of Section 199A, and Notice 2019-07 providing a safe harbor for when a rental real estate enterprise will qualify as a business for purposes of Section 199A. The rules surrounding the deduction, as well as the Final Regulations, are very complex, and taxpayers should consult with their tax advisors to determine the implications of the Section 199A deduction. Section 199A is effective until December 31, 2025.

Qualified Opportunity Zones

The TCJA provides federal income tax benefits for investing in businesses located in "Qualified Opportunity Zones". Opportunity zones are designed to spur economic development and job creation in distressed low-income communities in all 50 states, the District of Columbia, and US possessions. By investing eligible capital in a Qualified Opportunity Fund (a corporation or partnership that has at least 90 percent of its assets invested in qualified opportunity zone property on two measuring dates each year) that has invested in qualified opportunity zone property in any of these communities, and meeting certain other requirements, investors can gain certain tax benefits, including the deferral or exclusion of existing gain or non-recognition of gain. The Service issued proposed regulations and Rev. Rul. 2018-29 on October 19, 2018, and a second set of proposed regulations on April 17, 2019 which addressed, among other issues, what transactions would trigger recognition of previously deferred gains. The Qualified Opportunity Zone regime is complex and may impact the tax and estate planning of investors. Taxpayers should consult with their tax and estate planning advisors to discuss the potential tax benefits and implications.

Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act)

The SECURE Act was signed into law by President Trump on December 20, 2019 as part of the Further Consolidated Appropriations Act. Under the prior law, an IRA owner had to begin withdrawing required minimum distributions (RMDs) from a traditional IRA by April 1 of the year following the year the account owner turned 70 1/2. The SECURE Act increased the required minimum distribution age for taking RMDs from traditional IRAs from 70 1/2 to 72. This change is effective for distributions required to be made after December 31, 2019, for individuals who attain age 70 1/2 after that date.

Additionally, the SECURE Act changed the distributions of retirement accounts after the death of an IRA account owner. Under the prior law, a non-spouse designated beneficiary of an IRA was able to take distributions over the beneficiary's own life expectancy. Under the SECURE Act, non-spouse beneficiaries would generally be required to take complete distribution of inherited IRA benefits by the end of the tenth calendar year following the IRA owner's death. The 10-year term would apply regardless of whether the IRA owner died before his or her required beginning date. A designated beneficiary who is a spouse, minor child, disabled or chronically ill person, or person not more than 10 years younger than the IRA owner would be exempt from this rule. However, with respect to a minor child, the benefits must be distributed within 10 years from when the child attains the age of majority. This change is generally effective for persons dying after December 31, 2019.

The Coronavirus Aid, Relief and Economic Security Act (the CARES ACT)

The CARES Act — the largest stimulus package in history — was signed into law on March 27 as a $2.2 trillion economic stimulus to counter the adverse economic impacts of COVID-19. Among many other things, the CARES Act provided relief to businesses in the form of loans and tax benefits, as well as to individuals in the form of stimulus checks, unemployment benefits and tax benefits. The key provisions of the CARES Act as they relate to closely held businesses and high net worth individuals are summarized below.

Business Relief:

Paycheck Protection Program:

The Paycheck Protection Program (PPP) was established under the CARES Act as a $349 billion business loan program administered by the Small Business Administration. The funds allocated to the PPP were subsequently increased by an additional $320 billion and the Paycheck Protection Program Flexibility Act (the PPP Flexibility Act) further broadened the terms of the program.

Under the PPP, an eligible applicant may qualify for a loan of up to two and a half times its average monthly payroll costs (subject to certain adjustments), not to exceed $10 million dollars. The deadline to apply for a loan under the PPP was June 30.

The key feature of a PPP loan is that it is forgivable to the extent that the loan proceeds are applied towards payroll costs and certain nonpayroll costs (*e.g.*, mortgage interest, rent and utilities) over a period of either (1) eight weeks after funding or (2) the earlier of 24 weeks or December 31; provided, however, the proceeds applied towards payroll costs must equal at least 60 percent of the loan proceeds. To the extent that a PPP loan is not forgiven, it will be payable over a two-year period (or five years for loans made after June 5) at a 1 percent interest rate.

On April 30, the IRS issued the non-binding Notice 2020-32, which provides that certain expenses may not be deducted by a taxpayer to the extent that such expenses are paid for with the proceeds of a PPP loan and such amount is forgiven because amounts forgiven are excluded from gross income. Various legislators have criticized the Notice because it contradicts legislative intent and limits the efficacy of the PPP. Despite this criticism, no legislation to date has addressed the Notice.

Main Street Lending Program:

The Main Street Lending Program (the MSLP), which is administered by the Federal Reserve, is a $600 billion component of the CARES Act. The MSLP provides for non-forgivable loans to certain businesses with significant operations and a majority of their employees in the United States, if such businesses have less than 10,000 employees or revenues below $2.5 billion. A loan under the MSLP has a five year term, rate of LIBOR + 300 basis points and may be secured or unsecured. The Federal Reserve later expanded the MSLP to allow certain eligible non-profits to qualify for a loan under this MSLP.

Deferment of Social Security Taxes:

An employer may defer paying the employer's portion of an employee's social security taxes from March 27 to January 1, 2021. Half of the deferred taxes is due on December 31, 2021 and the remaining half is due on December 31, 2022.

Employee Retention Credit:

The CARES Act provides a refundable payroll tax credit equal to 50 percent of the first $10,000 of qualified wages paid to each employee from March 13 to December 31 by an employer whose operations were suspended or whose revenues significantly decreased due to COVID-19. If the employer averaged 100 or fewer full-time employees during 2019, qualified wages are those wages paid to employees during the period of reduced operations or decline in gross receipts; if the employer averaged more than 100 full-time employees during 2019, qualified wages are those wages paid to employees who are not providing services due to reduced operations or a decline in gross receipts during the applicable period. An employer is not eligible for the Employee Retention Credit if the employer received a PPP loan.

Net Operating Losses:

The CARES Act reverts the TCJA's limitation on the deductibility of net operating losses arising on or after the 2018 taxable year from 80 percent of taxable income to 100 percent and allows for a five-year carryback of net operating losses incurred in the 2018, 2019 and 2020 taxable years.

Individual Relief:

Charitable Deductions:

The CARES Act increased the adjusted gross income limitation for cash contributions made to qualifying charitable organizations from 60 percent to 100 percent of adjusted gross income. The CARES Act further permits taxpayers claiming the standard deduction to deduct (as an above-the-line deduction) $300 of cash contributions made to qualifying charitable organizations each year.

Excess Business Loss Limitation:

The CARES act repealed the excess business loss limitation under IRC Section 461(l) created by the TCJA for the 2018, 2019 and 2020 taxable years. Prior to the repeal, certain losses generated by a trade or business could only be used to offset up to $250,000 of non-trade or business income realized by an individual taxpayer (or $500,000 for married taxpayers filing jointly) and additional losses would be carried forward.

Business Interest Limitation:

Prior to the enactment of the CARES Act, certain taxpayers were only permitted to deduct business interest for a given taxable year up to the greater of (1) the taxpayer's business interest income; (2) 30 percent of the donors adjusted taxable income; or (3) floor plan financing interest. The CARES Act increased the 30 percent limit on the

donor's adjusted taxable income to 50 percent. Taxpayers with average gross receipts of less than $25 million (adjusted for inflation) over the prior three years are not subject to the business interest limitation.

Retirement Plans and Accounts:

The CARES Act provides that "qualified individuals" are eligible to withdraw up to $100,000 from qualified plans from January 1 to December 31. A "qualified individual" under the CARES Act, as modified by IRS Notice 2020-50, is generally an individual who was diagnosed with COVID-19 (or had a spouse or dependent diagnosed with COVID-19) or experienced some adverse financial consequence due to COVID-19 (or had a spouse or a member of the individual's household experience some adverse financial consequence due to COVID-19).

A qualified individual has three years to recontribute such distribution to the qualified plan to unwind the taxability of such distribution. If a qualified individual does not recontribute such distribution, the distribution will be subject to federal income tax, which will be paid ratably over a three-year period. To the extent that funds are recontributed, the ratable tax for the taxable year of the recontribution will be offset, and any excess may be carried forward to a subsequent taxable year or carried back to a prior year by filing an amended return for that prior year.

In addition to the foregoing, the CARES Act suspended a taxpayer's 2020 required minimum distribution (RMD) from a defined contribution retirement plan or IRA. The CARES Act also suspended a taxpayer's 2019 RMD for taxpayers required to take a first time RMD in 2019 by no later than April 1. IRS Notice 2020-51 permitted taxpayers who took said RMDs prior to the enactment of the CARES Act to rollover the RMDs previously taken into an IRA by August 31.

Important Cases Decided in 2020

Advances With No Loan Agreements, Security or Attempts to Force Repayment Are Loans or Gifts?

Estate of Bolles v. Comm'r, T.C. Memo. 2020-71

In *Estate of Bolles*, the Tax Court found that a decedent's transfers to her son over several years were initially loans to him but ultimately became a series of gifts. During her lifetime, decedent made a number of advances to her five children that she treated as loans. She forgave the "debt" account of each child every year on the basis of the gift tax exemption amount. Additionally, decedent transferred $1,063,333 to her oldest son Peter from 1985 to 2007. All amounts were recorded loans and interest was recorded, but no loan agreements or attempts to force repayment. In October 1989, decedent created an estate plan that excluded Peter from any testamentary distributions. From 1994 to 1995, decedent amended her estate plan and no longer explicitly excluded Peter but instead provided a formula to account for the "loans" made to him during her lifetime. In 1995, decedent and Peter signed an acknowledgment that recited that Peter has received, directly or indirectly, loans from decedent and that he has neither the assets, nor the earning capacity, to repay all, or any part, of the amount previously loaned. As a result, Peter acknoweldged and agreed that the entire amount of the loans to that date, plus imputed interest, should be taken into account for the new formula clause in decedent's estate plan.

The Tax Court relied on *Miller v. Comm'r*, T.C. Memo. 1996-3, aff'd, 113 F.3 1241 (9th Cir. 1997) in reaching its decision. In Miller, **the analysis of whether an advance is a loan or a gift is determined by a number of factors: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.**

The Tax Court noted that while decedent recorded the advances to Peter as loans and kept track of interest, **there were no loan agreements or attempts to force repayment**. As a result, the Court agreed that the reasonable possibility of repayment was an objective measure of decedent's intent. The Court concluded that the advances to Peter were loans through 1989, but were gifts after that.

Formula Clauses

Estate of Moore v. Comm'r, T.C. Memo 2020-40

In *Estate of Moore*, decedent transferred 4/5ths interest in a farm to a family limited partnership in exchange for a 95 percent limited partnership interest. A management trust held a 1 percent general partnership interest, and decedent's four children held the remaining 4 percent limited partnership interests, with 1 percent each. Two of the decedent's children were the trustees of the management trust. Shortly after the transfer of the interest in the farm to the FLP, the farm was sold. Decedent had begun negotiations to sell the farm prior to the transfer and unilaterally made the decision to sell once the interest was held by the FLP.

After the sale, decedent caused the FLP to issue checks for $500,000 to each of his four children, who provided notes for the funds, and $2 million to decedent's living trust, which he treated as a loan. Decedent subsequently gave $500,000 to an irrevocable trust for his children, which in turn purchased the 95 percent limited partnership interest for $500,000 cash and a note for $4.8 million.

The irrevocable trust also contained interesting language, providing that the trustees were to distribute to the living trust "an amount equal to the value of any asset of this trust which is includible in my gross estate." From the living trust, the trustees were to pay to a charitable lead annuity trust an amount that would "result in the least possible federal estate tax."

The Tax Court looked at (1) whether the value of the farm was included in the decedent's estate under Section 2036 despite its sale through the FLP, (2) if some of the value of the farm is included in the estate and whether the subsequent transfer of the living trust's interest in the FLP to the irrevocable trust removed that value, (3) whether deductions could be taken for (a) $2 million debt payable to the FLP, (b) future charitable contribution deductions, and (c) $475,000 in attorney's fees, and (4) whether the decedent's transfers of $500,000 to each of his children were gifts or loans.

The Tax Court ruled that the farm was includible in the decedent's gross estate under Section 2036(a)(1), as the bona fide sale for full consideration exception did not apply. **There was no active management of any business, the decedent's children did not actually manage sale proceeds in the FLP, there were no creditors (despite the children's claims at trial), and the entire plan was designed to be testamentary in nature.** The Tax Court also provided a lengthy analysis of Section 2043 in light of *Estate of Powell* but noted that the facts of this case did not make it easy to apply.

The Tax Court then disallowed any charitable deductions as a result of the formula clause in the decedent's living trust, noting that the actual language of the trusts prohibited the transfer. The language in the irrevocable trust was that the trustees were to pay to the living trust "an amount equal to the value of any asset *of this trust* which is includible in my gross estate for federal estate tax purposes." The farm, which was treated as includible in the decedent's gross estate under Section 2036(a)(1), was not an asset of the irrevocable trust; it was sold. Additionally, the Tax Court noted that **the charitable amount was not ascertainable at the time of the decedent's death and instead would only be ascertainable after an audit by the IRS.**

Finally, the Tax Court determined that the $500,000 transferred to each of the decedent's children were gifts, not loans, and that subject to Section 2503(b), additional gift tax was owed because the gifts were made within three years of the decedent's death.

Nelson v. Comm'r, T.C. Memo 2020-81

In *Nelson*, Mrs. Nelson transferred a 27 percent interest in a family holding company to a family limited partnership. She subsequently gifted and sold limited partnership interests in the FLP to a trust for the benefit of her husband and four daughters. The Gift and Assignment of Limited Partner Interest provided that she desired to make a gift and assign to the trust her right title and interest in a limited partner interest having a fair market value of $2.096 million as of December 31, 2008, as determined by a qualified appraiser within ninety (90) days of the effective date of the assignment. The Memorandum of Sale and Assignment of Limited Partner Interest provided that she desired to sell and assign to the trust her right title and interest in a limited partner interest having a fair market value of $20 million as of January 2, 2009, as determined by a qualified appraiser within ninety (90) days of the effective date of the assignment. These values equated to a transfer of a gift of a 6.14 percent limited partner interest in 2008 and a sale of a 58.65 percent limited partner interest in 2009.

The IRS took the position that the appraiser, and consequently Mrs. Nelson, undervalued the value of the limited partnership interests gifted and sold to the trust and that additional gift tax was owed. After a lengthy analysis of formula and savings clauses, the Tax Court noted that **neither of the assignments contained clauses defining fair market value or subjecting the limited partner interests to reallocation after the valuation date. Instead, they were actually a transfer of a dollar value rather than a particular percentage limited partnership interest.** In making this determination, the Tax Court noted that **the language in the documents called for the specified amount to be determined by an appraiser within a fixed period; the value was not qualified further, for example, as that determined for Federal estate tax purposes.**

In determining the amount of the additional gift tax owed, the Tax Court reviewed all of the discounts taken by Mrs. Nelson, both at the level of the holding company and the family partnership level. At the holding company level, the Tax Court allowed a lack of control discount of 15 percent (Mrs. Nelson took a 20 percent discount and the IRS wanted a 0 percent discount). At the limited partnership level, the Tax Court allowed a 5 percent lack of control discount (Mrs. Nelson took a 15 percent discount and the IRS wanted a 3 percent discount) and a 28 percent lack of marketability discount (Mrs. Nelson took a 30 percent discount and the IRS wanted a 25 percent discount). Accordingly, while the Tax Court held that there was additional gift tax owed by Mrs. Nelson, it upheld the use of multi-tiered discounts by Mrs. Nelson.

President-Elect Joe Biden's Tax Plan

Overview

As discussed above, President Trump's administration enacted the TCJA, overhauling the tax code in effect at the time. Generally, the TCJA reduced tax rates for the individuals, corporations, trusts and estates. President-Elect Joe Biden is critical of the TCJA, having contended that the reductions favored those in the highest income tax brackets. In an effort to correct this perceived disparity, Biden has made the following proposals and has indicated the following intentions (collectively, the "Biden Plan"), aimed at raising taxes at the top levels. The key features of the Biden Plan from an estate-planning perspective are the increase in top individual income tax rates, the limitation on deductions, the taxation of capital gains as ordinary income, the repeal of stepped-up basis at death, and the reversion of the Federal exemption amount to pre-TCJA levels.

Individual Income Tax

The Biden Plan would restore the top individual income tax rate to its pre-TCJA rate of 39.6 percent. The Biden Plan would apply the same 39.6 percent rate to carried interest income, eliminating the special treatment of carried interest, and, for those with income of more than $1 million, capital gains and dividends (including the Medicare surtax, the top long-term capital gain and qualified dividend tax rate would be 43.4 percent). Taxpayers with income

of more than $1 million might also face a mark-to-market regime for capital gains and dividends. Taxpayers with income under $400,000, however, should not see their individual income taxes raised.

The Biden Plan would make a number of changes to deductions under the current TCJA. Most significantly, it would cap the value of itemized deductions at 28 percent and would reinstate the Pease limitation on itemized deductions for higher-income taxpayers. Additionally, the Biden Plan would repeal the Section 199A qualified business income deduction for taxpayers with income in excess of $400,000 and reinstate the state and local income tax deductions that were repealed under the TCJA.

Moreover, in an effort to close the income gap between wealthy and lower-income Americans, the Biden Plan would expand certain credits available to low- and middle-income taxpayers. Specifically, the Biden Plan proposes temporarily expanding the child tax credit to $3,000 per child for children ages six to 17 and to $3,600 for children under six during the pendency of COVID-19. It would also expand child and dependent care credit to $8,000 per child, making it refundable and payable in advance. Biden also proposes forgiving student loan debt and not subjecting the forgiven debt to tax, expanding the work opportunity tax credit to include military spouses, enhancing access to 401(k) plans for workers, expanding the earned income tax credit for childless workers aged 65 and older, expanding access to ABLE accounts and providing renewable energy-related tax credits to individuals. The Biden Plan suggests creating a new refundable tax credit of up to $15,000 for first-time homebuyers, which would be paid when a buyer purchases a home (instead of on filing of the tax return following the purchase). He supports enacting a new renter's tax credit to reduce rent and utility costs to 30 percent of income for low-income individuals and supports expanding the low-income housing tax credit.

For payroll taxes, the Biden Plan proposes a 12.4 percent Social Security Disability tax, split equally between employers and employees, on wages earned above $400,000. This tax would create a "donut hole," where wages between $137,700, the current wage cap, and $400,000 would not be taxed for Social Security. In addition, Biden would create a $5,000 credit for long-term caregivers of elderly relatives or loved ones.

Property and Corporate Tax

The Biden Plan proposes eliminating or phasing-out Internal Revenue Code Section 1031 "like-kind" exchanges. It is also possible that Section 1031 would apply only to individuals with taxable income under $400,000. Reform of Section 1031 in any capacity would raise significant revenue and could be seen as protecting small business. Biden's proposals might also limit the ability of real estate investors with incomes of more than $400,000 to take losses as deductions against taxable income.

The Biden Plan would also eliminate the bonus depreciation rule for commercial property implemented under the TCJA, which defines internal improvements on commercial property as "qualified improvements," reduces the depreciation life of qualified improvements to 15 years (from 30 years), and allows qualified improvements to have first year bonus depreciation of 100 percent. Biden's proposal would revert the depreciation lives to 25 years for residential property and 39 years for commercial property.

The Biden Plan would increase the corporate tax rate from 21 percent to 28 percent with a 15 percent minimum tax on book income of corporations with income of $100 million or more. Biden also supports a repeal of the temporary net operating loss (NOL) provisions of the CARES Act, enacted in response to COVID-19, which allows NOLs incurred in 2018, 2019 and 2020 to be carried back for up to five years, while concurrently suspending the 80 percent taxable limit otherwise imposed for utilizing such NOLs.

In addition, Biden proposes increasing the global intangible low tax income (GILTI) rate on foreign income from 10.5 percent to 21 percent and imposing a 10 percent tax penalty on corporations that create jobs overseas and sell products back to America in order to avoid US income taxes. He also supports a "claw-back" provision to force

companies to return public investments and tax benefits when they eliminate jobs in the United States and send them overseas. There would also be an elimination of deductions for any expenses associated with sending jobs overseas.

On the other hand, Biden proposes tax credits for certain domestic business owners. For example, Biden supports a new manufacturing communities tax credit that would promote revitalization and renovation of existing or recently closed facilities. Projects receiving the credit would have to benefit local workers and communities. He also supports a new 10 percent "Made in America" tax credit for companies that invest in the United States, in order to help revitalize the US manufacturing industry.

The Biden Plan proposes creating tax credits for small businesses that offer retirement plans to employees, creating tax credits for employers who hire disabled workers and providing up to $30,000 in tax credits to businesses that improve the handicap accessibility of their workplace.

Estate, Gift, and Generation-Skipping Transfer Tax

President-Elect Biden has expressed an intention to decrease an individual's Federal estate tax exemption amount either to $5 million per individual (and $10 million for a married couple) or to the pre-TCJA amount of $3.5 million per individual. This could be coupled with an increased top rate of 45 percent. Additionally, although Biden does not support a "wealth tax," the Biden Plan might repeal stepped-up basis at death and, moreover, may cause unrealized capital gains to be taxed at death using the proposed increased capital gains tax rates.

Likelihood of Enactment of the Biden Plan

Whether any of the measures included in Biden's proposals will become law has yet to be seen. The enactment of Biden's proposals will depend in large part on the make-up of Congress. As of now, while the House appears to have a Democratic majority, the outcome of the Senate race is less clear. As of the time of drafting this Advisory, the Republicans have won 50 seats in the Senate and the Democrats have won 48 seats. The remaining two seats will be determined by the run-off elections in Georgia, which are to take place on January 5, 2021. If one of these seats is won by the Republican candidate, it will prove very difficult for Biden's Plan to become law, considering Biden will need at least 11 Republicans to cross the aisle to pass any measure that does not impact revenue or spending. However, if both seats are won by Democrats, the President-Elect would be able to take advantage of "Budget Reconciliation," which is a streamlined process for approving bills impacting revenue or spending and requires only a simple majority for passage. With a Senate divided 50-50, the tie-breaking vote would be in the hands of Vice President-Elect, Kamala Harris, and Biden's Plan could be passed into law. Even were that the case, however, it is unclear that every measure in the Biden Plan would receive unanimous Democratic support in the Senate. Finally, one needs to consider the effective date of any measures in the Biden Plan that may ultimately be enacted. Typically tax legislation is prospective and might not be effective until January 1, 2022 or later (depending upon how long the enactment process takes). Sometimes, however, tax legislation is retroactive, in which case it would either be effective as of the date of introduction (which would in all events be sometime after the inauguration) or possibly even effective as of January 1, 2021. Much remains to be seen.

Important Planning Considerations for 2020 and 2021

Given the changes implemented by the TCJA and the potential for the implementation of the Biden Plan in 2021, taxpayers should review their existing estate plans and consult with their tax advisors about how, where appropriate, best to take advantage of the higher exemption amounts while they are in all events available. The following is a summary of several items that should be considered:

Review Formula Bequests

Many estate plans utilize "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 $11.58 million in 2020 and $11.7 million in 2021. 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. 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 utilizing 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;
- utilizing 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 exclusion 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 towards 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.

Planning to Utilize 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, and as part of a deal to make other changes, the exemptions may remain where they are). Depending on the ultimate makeup of the Senate, and the potential for the implementation of Biden's Plan, it may be prudent to make use of the increased amount in 2020 and/or early in 2021.

Gifting Techniques to Take Advantage of the Increased Applicable Exclusion Amount

Taxpayers may want to consider making gifts to utilize the increased Federal exclusion amount. It is less expensive to make lifetime gifts rather than making 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 and appreciation on the gift from their estate. However, taxpayers should seek advice if they have used all of their applicable exclusion 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. 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 exclusion amount. For individuals with assets far exceeding their applicable exclusion amounts, lifetime gifting of high-basis assets generally may be recommended. However, individuals with total assets close to or below their applicable exclusion amounts should exercise caution before making gifts of low basis assets. Instead, those individuals should consider holding their assets until death in order 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. We are available to discuss this analysis with you in more detail.

If undertaking a gifting strategy, gifts to utilize 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 utilizing 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 needs 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 exclusion amount will increase by $120,000 ($240,000 for a married couple) in 2021. Therefore, even if a taxpayer uses some or even all of the available applicable exclusion amount before the end of 2020, additional gifts may be made in 2021 without paying any Federal gift tax. Based on current law, the applicable exclusion amount also will be adjusted for inflation in future years. Those resident in Connecticut should be mindful that Connecticut is the only state with a state level gift tax.

Other Techniques to Take Advantage of the Increased Applicable Exclusion Amount

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

- **Sales to Trusts.** Taxpayers should also consider utilizing 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 while interest rates are at historic lows. 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.

- **Loan Forgiveness/Refinancing.** If taxpayers are holding promissory notes from prior estate planning transactions, from loans to family members, or otherwise, they should consider utilizing some or all of the increased Federal exemption amounts to forgive these notes. Alternatively, consideration should be given to refinancing existing notes at the current, historically low interest rates.
- **Allocation of GST Exemption to GST Non-Exempt Trusts. I**f a taxpayer's existing estate plan utilizes 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 ($157,000 in 2020) to avoid Federal gift tax. Note that the annual exclusion for gifts (to donees other than a spouse) is $15,000 in 2020.
- **Life Insurance**. Taxpayers may wish to review or reevaluate their life insurance coverage and needs with their insurance advisors.
- **Other Planning Options.** Taxpayers should also consider other means for utilizing the increased Federal exemption amounts, such as triggering a transfer under Section 2519 of the Code of a surviving spouse's qualified terminal interest property in a marital trust or the formation and funding of an entity that purposely violates Code Section 2701, in each case utilizing the increased Federal gift tax exemption amount.

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 exclusion 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 exclusion 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 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 exclusion amounts should be reviewed to ensure that it is utilized most effectively if one wishes to plan for grandchildren or more remote descendants. In addition, due to the 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 in 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. 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 (which, for taxpayers dying before 2026, should be $10 million adjusted for inflation), 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 utilizing 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.

Same-sex couples should continue to review and revise their estate planning documents and beneficiary designations now that same-sex marriages must be recognized by every state as well as by the federal government. Same-sex couples may want to ensure that the amount and structure of any bequests to the spouse are appropriate, as well as consider the benefits of split-gifting for gift tax purposes. Same-sex couples should also consider amending previously filed federal estate, gift and income tax returns and state income tax returns, as well as reclaiming applicable exclusion and GST exemption amounts for transfers between the spouses made before same-sex marriages were recognized for federal tax purposes (assuming any applicable statutes of limitations have been tolled).

Unmarried couples should particularly continue to review and revise their estate planning documents and beneficiary designations, as 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 filers, $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 techniques that have been utilized in prior years continue to be advantageous planning techniques under the TCJA. Due to potential sunset 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 (GRATs)

Grantor retained annuity trusts (GRATs) remain one of our most valuable planning tools, particularly in times of historically low interest rates. Due to the current historically low interest rates and the fact that prior administrations' presidential budget proposals frequently called for adverse changes in how GRATs may be structured (although to date the Biden Plan does not call for a change in this regard), consideration should be given to creating GRATs as soon as possible. Under current law, GRATs may be structured without making a taxable gift. Therefore, even if one has used all of his or her applicable exclusion 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 2020 is 0.40 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 intentionally defective grantor trusts (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 2020 is as low as 0.13 percent for a short-term note), as with a GRAT, the appreciation beyond the federal rate will pass free of gift and estate tax. Due to the current low interest rates, now is an opportune time to structure sales to IDGTs.

The current environment creates a window of opportunity for sales to grantor trusts. 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 $11.58 million (or $23.16 million, if splitting assets with a spouse) to a grantor trust in 2020. This would permit the sale of up to $115.8 million (or $231.6 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.

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

Because interest rates are currently low (and 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 exclusion 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.*, 0.39 percent is the mid-term AFR in November 2020) 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.

Purposely Triggering Application of Section 2701

A taxpayer may desire to utilize the increased gift and estate tax exemption prior to the scheduled sunset and may also desire to shift appreciation on this amount to a trust for the benefit of the taxpayer's children that is removed from the estate tax system. This desire may be met with hesitation to part with $11.58 million of assets. The taxpayer may also be concerned about losing cash flow from the transferred assets and not having the option of taking the property back if needed in the future. Finally, the taxpayer may also have concerns that assets available for transfer have a low-income tax basis, which will carry over if a traditional gift is made.

A planning alternative exists which can potentially address each of these concerns. The strategy is to create and fund a preferred partnership, which is structured to purposely violate Section 2701 of the Code.

Assume taxpayer gifts $1.1 million to an irrevocable trust for the benefit of the taxpayer's children (Family Trust). Taxpayer and Family Trust create a preferred partnership (PP). Taxpayer transfers to the PP $9.9 million of low basis assets in exchange for a preferred interest, entitling the taxpayer to a 5 percent non-cumulative preferred return and the right to put the preferred interest to the PP for an amount equal to its associated capital account. The Family Trust contributes $1.1 million to the PP in exchange for a common interest, entitling the Family Trust to all cash flow above the 5 percent payment made to the preferred interest and all appreciation on the PP's assets.

Structuring the preferred interest in this manner violates Section 2701 of the Code. The result is a deemed gift of $9.9 million, which combined with the taxpayer's gift of $1.1 million to the Family Trust means the taxpayer has consumed $11 million of gift and estate tax exemption. Also, when the taxpayer dies, the preferred interest will be included in the taxpayer's estate under Section 2033 of the Code, resulting in an income tax basis step up of the preferred interest. The estate tax calculation will include a reduction in the taxpayer's tentative taxable estate of $9.9 million, to account for the prior taxable gift and avoid double taxation.

This structure has addressed each of the taxpayer's concerns. The taxpayer has consumed the increased exemption amount but has done so in a manner that preserves an income tax basis step up. The taxpayer has also retained a 5 percent return on the preferred interest and the right to put the interest back to the PP and take back the value of the taxpayer's capital account. Finally, cash flow above the 5 percent preferred return and appreciation on the PP's assets have been shifted to the Family Trust free of transfer taxes.

Consider Charitable Planning

As noted above, the TCJA increased the AGI percentage limit for cash contributions to public charities from 50 percent to 60 percent. Because of the increased percentage limitation, consideration should be given to accelerating charitable giving to possibly obtain a current income tax deduction and potentially reduce one's taxable estate (of both the contributed asset, as well as future appreciation).

A planning tool that is very effective in a low interest rate environment is a Charitable Lead Annuity Trust (CLAT), which combines philanthropy with tax planning. 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 (0.40 percent for November), those assets can pass transfer tax free to the chosen beneficiaries. Alternatively, a strategy that works better in a high interest rate environment is a Charitable Remainder Annuity Trust (a CRAT). 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. A CRAT may become an attractive option if interest rates rise.

The Qualified Charitable Distribution rules were made permanent by the Tax Hikes (PATH) Act of 2015 on December 18, 2015. The PATH Act permanently extended the ability to make IRA charitable rollover gifts, which allow an individual who is age 70 1/2 or over to make a charitable rollover of up to $100,000 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 for 2020, he or she may arrange for the distribution of up to $100,000 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. The Qualified Charitable Distribution rules allow taxpayers who are claiming a standard deduction to still obtain a financial benefit from charitable donations.

Year-End Checklist for 2020

In addition to the above planning ideas, consider the following before 2020 is over:

- Make year-end annual exclusion gifts of $15,000 ($30,000 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 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) before year-end to use the deduction on your 2020 income tax return.

Below is an overview of national, international and local developments that occurred in 2020.

International Developments in 2020

The global pandemic consumed the IRS and Treasury's attention in the beginning half of 2020 in respect of US tax guidance affecting the international private client. As the work force began to function remotely in late February and early March, the IRS and Treasury focused on relief in respect of US tax compliance deadlines. Thereafter, the focus turned to providing relief in respect of the tax consequences of certain provisions in the Internal Revenue Code impacted by travel disruptions. During the latter half of the year, the IRS and Treasury continued its "business as usual"— albeit, likely remote — proposing and finalizing certain regulations related to changes from the TCJA.

Relief for Certain Tax Filing Deadlines and Travel Disruptions

Regarding deadlines, Notice 2020-18 postponed the due date of federal income tax returns and payments that were due on April 15 to July 15. The IRS also published FAQs to supplement the relief provided in Notice 2020-18. Unfortunately, neither Notice 2020-18 nor the FAQs discussed the extent to which the automatic extension for federal income tax returns applied to certain international income tax returns or information returns. To clear concerns raised by the tax practitioner community, the IRS published Notice 2020-23, which provided extensions of time to file almost all international income tax returns or information returns, including Forms 1040-NR, 1120-F, 706-NA, 3520, 5471, 5472, 8621, 8858, 8865, and 8938. Unfortunately, Notice 2020-23 did *not* extend the due date for Form 3520-A, which is generally due on March 15 of each year.

Substantial travel disruptions, caused by the pandemic, caused the IRS to provide guidance focused on relaxing rules related to US income tax residency (involving, for example, the substantial presence test and treaty benefits), the foreign earned income exclusion and the existence of a US trade or business.

Treasury promulgated Revenue Procedure 2020-20 to provide relief to certain individuals who were physically present in the United States long enough in 2020 to be considered US income tax residents under the substantial presence test solely due to travel and related restrictions due to the global pandemic. More specifically, Revenue Procedure 2020-20 provides procedures to claim the medical condition exception to the substantial presence test for a period up to 60 consecutive days spent in the United States for time periods starting on or after February 1 and on or before April 1 with specific start date to be chosen by the individual. It is noteworthy that an individual did not have to be ill during the period covered by Revenue Procedure 2020-20; the global pandemic itself constituted a medical condition for purposes of the foregoing exception, regardless of whether the individual was infected. Revenue Procedure 2020-20 also allowed those same individuals to exclude the same number of physical days of presence in order to claim benefits under an applicable income tax treaty in respect of dependent personal services income. In addition to the foregoing, FAQs were issued to provide relief to individuals who fell or may have fallen ill in connection with the global pandemic but were unable to leave due to such illness. The FAQs allow such individuals to claim the medical condition exception in respect of a single period of up to 30 consecutive days *without* a physician's statement. Notably, the excluded 30-day period contemplated in the FAQs is in addition to the 60-day relief provided for in Revenue Procedure 2020-20.

Notwithstanding the relief provided for in Revenue Procedure 2020-20 and the associated FAQs, given that residency for state and local income tax purposes does not necessarily track all relief granted for US federal income tax purposes, practitioners and clients should be mindful to consider tax residency issues at the state and local level due to the global pandemic.

Treasury promulgated Revenue Procedure 2020-27 to provide relief to certain US citizens or residents who would otherwise constitute a "qualified individual" for purposes of the foreign earned income exclusion but for travel impediments due to the global pandemic. More specifically, under Code Section 911, an individual who fails to meet the definition of a "qualified individual" because such individual is required to leave a foreign country due to war, civil unrest, or similar adverse conditions may constitute a "qualified individual" and still be eligible for the foreign earned

income exclusion. Revenue Procedure 2020-27 establishes that the global pandemic constitutes a “similar adverse condition” for purposes of the Code Section 911. The global pandemic constitutes an “adverse condition” beginning as of December 1, 2019 for Hong Kong and Macau, and the remainder of the globe as of February 1, and in each case ending on July 15.

The IRS also issued FAQ to provide narrow relief to certain non-US taxpayers regarding the extent to which such taxpayers are engaged in a US trade or business. More specifically, foreign corporations, foreign partnerships and nonresident aliens individuals may choose an uninterrupted period of up to 60 calendar days beginning on or after February 1 and ending on or before April 1, during which services or other activities conducted in the United States will not be taken into account in determining whether such taxpayers are engaged in a US trade or business. However, the relief only applies in respect of activities that are performed by an “individual temporarily present in the United States” *and* that would not have been performed in the United States but for travel disruptions caused by the pandemic. The FAQ also provided that temporarily present individuals would not be taken into account for determining whether a foreign corporation had a permanent establishment for treaty purposes. In addition to the narrow utility of the relief, the FAQs were silent on the sourcing of activities of an “individual temporarily present in the United States,” which begs the question whether a non-US taxpayer would want to qualify for the relief since any such US source income would be subject to tax on a gross basis.

(Remote) Business as Usual — Proposed and Finalized Regulations

Treasury finalized and proposed several clarifying regulations impacted by the changes made pursuant to the TCJA. This included final regulations and proposed regulations in respect of Code Sections 958 (on removing the provisions precluding downward attribution — the so-called “Downward Attribution Rule”), 951A (on clarifying the scope of the high-tax exception), and 864(c)(8) (on elaborating in respect of the provisions overruling *Grecian Magnesite*).

As outlined in our 2019 Trust and Estates Advisory, literal application of the Downward Attribution Rule (inadvertently) caused many foreign corporations to constitute CFCs despite US persons directly or indirectly owning nominal interests. Proposed regulations sought to address situations — on a code section by code basis — on how the Downward Attribution Rule should be applied to prevent unintended classification of foreign corporations as CFCs. In September, Treasury finalized the proposed regulations with minimal change. At the same time, Treasury promulgated a new set of proposed regulations related to the Downward Attribution Rule. The new proposed regulations modify the attribution rules as applicable to outbound transfers under Code Section 367, as well as narrow the application of the look-through rule under Code Section 954(c)(6) (in respect of the exclusion for Subpart F income).

In July, Treasury issued final regulations that expand the application of the high-tax exclusion under the global intangible low-taxed income (GILTI) regime. With a couple of noteworthy modifications, the final regulations generally follow the structure of the 2019 proposed regulations, which clarified that the high-tax exclusion as applicable to GILTI covers any gross income subject to foreign income tax at an effective rate greater than 90 percent of the US corporate income tax rate (*e.g.*, 18.9 percent based on the current 21 percent rate). The modifications from the proposed regulations include revamping the approach for determining the effective tax rate on a “tested unit” basis and providing a more favorable annual election period as opposed to the five-year binding election. Additionally, the final regulations may be applied retroactively to tax years of foreign corporations that begin after Dec. 31, 2017, providing more flexibility.

Final regulations were also issued in respect of Code Section 864(c)(8), which largely follow proposed regulations issued in late 2018. Briefly put, the proposed regulations provide rules for determining the amount of gain or loss treated as effectively connected with the conduct of a trade or business within the United States when a non-US person has a realization event in respect of an interest in a partnership that is engaged in a US trade or business. The

final regulations include some noteworthy additions, such as limiting the extent to which certain property held by the partnership is deemed to give rise to US source income or loss, expanding on the coordination of Code Section 864(c)(8) and US income tax treaties, and clarifying the extent to which Code Section 897 may otherwise apply. Importantly, the final regulations have retroactive effect to December 26, 2018.

IRS Audit Programs Targeting International Private Clients

On a more proactive note, the IRS's Large Business and International Division recently launched two audit campaigns related to non-US persons who own US real estate. The IRS announced the first campaign on September 14, and this campaign targets compliance in respect of FIRPTA tax withholding and reporting obligations on the buyer of US real estate owned by a non-US seller. The IRS announced the second campaign on October 5, and this campaign targets US federal income tax compliance of nonresident aliens who receive rental income from US real estate. Both campaigns will broadly address noncompliance through examination, education and outreach.

Supplementing the IRS's aggressive audit campaigns targeting international information return compliance, the IRS recently changed its practice involving assessment of penalties under the delinquent international information return submission procedures. Previously, US income tax residents could file delinquent international information returns with a reasonable cause statement, in which case the IRS would waive penalties for non-compliance to the extent the taxpayer established reasonable cause. The IRS recently changed its position and has communicated that it may assess the penalties "without considering" the reasonable cause statement and that taxpayers may need "to respond to specific correspondence and submit or resubmit reasonable cause information." In essence, US citizens and other tax residents coming clean with the IRS for failure to timely file international information returns face less certainty when dealing with the IRS on these issues and could be assessed penalties irrespective of the existence of reasonable cause.

Year-End US Tax Planning Opportunities for International Private Clients

As discussed above, the potential implementation of the Biden Plan would impact potential year-end US tax planning opportunities for international private clients. Specifically, Biden proposes increasing the GILTI rate on foreign income from 10.5 percent to 21 percent and imposing a 10 percent tax penalty on corporations that create jobs overseas and sell products back to America in order to avoid US income taxes. He also supports a "claw-back" provision to force companies to return public investments and tax benefits when they eliminate jobs in the US and send them overseas. There would also be an elimination of deductions for any expenses associated with sending jobs overseas. International private clients with investments in the US should consider triggering gains in 2020 to avail themselves of potentially lower US income tax rates and examine existing US investment structures in light of potential US tax increases. Clients should consider taking these measures in 2020 as any US tax reform passed by the Democrats in 2021 could theoretically be made retroactive to January 1, 2021.

Local Developments in 2020: State-Specific Considerations

California

Remote Online Notarization in California

Unlike the other states that will be discussed in this Advisory, California law does not presently provide California notaries public with the authority to perform remote online notarizations. A document signer is required to appear in person before a California notary public for a notarization to be valid under the current law. However, California does recognize the validity of notarizations performed remotely in accordance with the laws of jurisdictions permitting remote online notarizations.

Attempts to authorize remote online notarizations were made earlier in 2020, but were unsuccessful. Senate Bill 1322 — the Remote Online Notarization Act (SB 1322) was first introduced to the California Senate on February 21. SB 1322 would have allowed remote online notarization in California temporarily while the COVID-19 state of emergency is in effect. SB 1322 was scheduled for a hearing on May 22, but the hearing was cancelled and there has been no progress with respect to SB 1322 since. Further, Assembly Bill 2424 — Notaries Public: Disclosures (AB 2424) was introduced to the California State Assembly on February 19. AB 2424 would have authorized remote online notarization on a permanent basis in California. AB 2424 was referred to the California Assembly's Judiciary Committee on April 24 and re-referred to the Judiciary Committee on May 5. There has been no movement on AB 2424 since.

Greater Restrictions on Residential Property Transfers (Proposition 19)

In the November election, California voters decided to pass Proposition 19 — the Property Tax Transfers, Exemptions and Revenue for Wildfire Agencies and Counties Amendment. The ballot measure changes the rules for tax assessment on property transfers and has a significant impact on the assessment of inherited properties. In California, parents can transfer primary residential properties to their children without the property's tax assessment reverting to market value. Other properties, such as second residences (*e.g.*, vacation homes) and commercial properties can also be transferred from parent to child with the first $1 million of such property's assessed value exempt from reassessment to market value when transferred.

Proposition 19 eliminates the parent-child exemption in cases where the child does not use the inherited property as his or her principal residence (*e.g.*, if the child uses the property as a rental property or a vacation home). When the inherited property is used as the recipient's principal residence and the market value of the property exceeds the property's taxable value by more than $1 million, an upward adjustment in assessed value will occur and the property will be reassessed at market value. These changes will take effect on February 16, 2021.

Trust Income Derived from California Sources Subject to California Income Tax

In *Steur v. Franchise Tax Board*, the California Court of Appeal held that the State of California imposes income tax on the entire amount of trust income derived from California sources, regardless of whether the trustees are California residents.

The case was an appeal from a 2018 decision in which the San Francisco County Superior Court reversed the California Franchise Tax Board's long-standing position that all of a trust's California source income is fully taxable and not subject to an apportionment regime. California's apportionment regime is a two-tier approach used for determining whether a trust's income is taxable in California based on the residence of a trust's fiduciaries and noncontingent beneficiaries. Taxable income is first apportioned in proportion to the number of California fiduciaries over the number of total fiduciaries. The amount remaining after applying the first tier is then apportioned in proportion to the number of California noncontingent beneficiaries over non-California noncontingent beneficiaries.

In *Steur*, the grantor of the trust established an absolute discretion trust for the benefit of his California resident daughter, who received discretionary distributions. The trust had two trustees, one a California resident and the other a Maryland resident. The trust document authorized, but did not require, the trustees of the trust to make distributions to the beneficiary. In 2007, the trustees sold stock, which generated capital gains on California-sourced income. The capital gains were initially reported on the trust's fiduciary income tax return, and the trust paid income tax on said gains. In 2012, the trustees filed an amended fiduciary income tax return for 2007, alleging an overpayment and requesting a refund on the theory that they should have apportioned one-half of the capital gains to the California trustee and one-half to the Maryland trustee, with the Maryland trustees' half generating

no California tax. The San Francisco County Superior Court held that the trust's California taxable income should have been determined by the apportioning it income one-half to its California trustee and one-half to its Maryland trustee. The Franchise Tax Board appealed.

The Court of Appeal reversed the trial court's ruling regarding the apportionment between the California trustee and the Maryland trustee. The Court reasoned that **a trust is taxed on all of its California-sourced income irrespective of the situs of the trustee.** Further, the court held that **apportionment based on trustee residency only applies to non-California-sourced income.** Taxable income of any nonresident includes California-sourced-income, and the calculation for a trust's taxable income is no different. Accordingly, the trustees were not entitled to apportionment of the California-sourced-income based on a trustee's Maryland residency.

Moreover, the Court of Appeal upheld the Superior Court's ruling that the beneficiary of the trust was contingent as the distributions were discretionary. Thus, the trust was not considered taxable on all of its income based on the beneficiary's California residence and the trust's non-California source income is apportionable.

The California Supreme Court has declined to review the Court of Appeal's decision.

<u>A General Disinheritance Clause is Sufficient to Express Decedent's Intent</u>

In *Rallo v. O'Brian*, the California Court of Appeal held that a general disinheritance clause is a sufficient expression of the decedent's intent to disinherit potential heirs living at the time of the execution of a will or trust, even if the potential heir is unknown to the decedent.

The decedent in *Rallo* established a living trust for the benefit of his spouse, friends, family and various charities following his death. Although the decedent did have two biological children of whom he was aware, the trust instrument did not provide for them. In addition, the decedent had two biological children of whose existence he was unaware (the omitted children). The omitted children attempted to collect an intestate share of the estate on the basis that they were omitted solely because the decedent was unaware of their birth. However, the trust instrument contained a general disinheritance clause, indicating the decedent intentionally omitted any of his heirs who may be living at his death, as well as any person claiming to be an heir of the decedent.

Although the Court noted that omitted children born before the execution of a testamentary document have a statutory right of recovery of an intestate share of a decedent's estate if the sole reason for the omission was because the decedent was unaware of the omitted child's birth, the burden of proof is on the omitted child to establish this lack of awareness. The omitted children in *Rallo* failed to prove that the sole reason they were omitted from the decedent's estate plan was because the decedent did not know they were born. Further, the Court held that **the use of a general disinheritance clause can be used to express intent to disinherit potential living heirs at the time of execution of a testamentary instrument, even if such heir is not known to the decedent.**

<u>A Power of Appointment Must be Specifically Referenced to Preserve a Testamentary Gift</u>

In *Estate of Eimers*, the California 2nd District Court of Appeal held that, although reforming a will is permissible if extrinsic evidence establishes a testator's intent, a will cannot be reformed if it runs afoul of the power of appointment requirements in the California Probate Code.

The testator in *Estate of Eimers* was a beneficiary of a trust established by his parents. The trust included a testamentary power of appointment for the testator to dispose of the remaining trust estate upon his death. The trust instrument allowed the testator to appoint his share of the trust estate only by way of a will that specifically referred to and exercised the power of appointment. The testator died in 2013 leaving a holographic will that provided "[t]o Charles J. Saletta and Caryn Saletta I hereby leave my shares of the Norbert Theodore Eimers Family Trust."

The trustee of the trust filed a petition in Sonoma County asking for instructions on whether he could distribute the testator's share of the trust to the Salettas. The Sonoma County Superior Court found that the holographic will did not comply with the trust's requirement that the will specifically reference the power of appointment, and so the will did not qualify as a valid exercise of the testator's power of appointment. The Salettas appealed, and 2nd District Court of Appeal affirmed the lower court rulings.

Ultimately, the 2nd District Court of Appeal held **that a court cannot reform a will to create a specific reference to a power of appointment where the creating instrument required a specific reference to such power because to do so would violate the California Probate Code.** Section 630 of the California Probate Code provides that **if the creating instrument specifies requirements as to the "manner, time, and conditions of the exercise of a power of appointment, the power can be exercised only by complying with those requirements."** Further, Section 632 of the California Probate Code holds that **"[i]f the creating instrument expressly directs that a power of appointment be exercised by an instrument that makes a specific reference to the power or to the instrument that created the power, the power can be exercised only by an instrument containing the required reference."** While it was clear that the decedent intended to exercise his power of appointment in favor of the Salettas, the 2nd District Court of Appeal found the gift could have no effect because the decedent did not include a specific reference to his power of appointment in his will.

Illinois

Remote Notarization and Witnessing

On June 12, Illinois Senate Bill 2135 was signed into law as Public Act 101-0640. The law, which was immediately effective, fulfilled two (2) important objectives. First, it gave statutory approval to all of Governor Pritzker's prior Executive Orders allowing remote notarization and witnessing and second, it made future remote notarization and witnessing statutory in nature. Prior to Public Act 101-0640, Governor Pritzker issued multiple Executive Orders authorizing documents to be remotely notarized and witnessed due to ongoing health considerations with respect to in-person execution of documents due to COVID-19. With the Illinois legislature implementing legislation acknowledging and blessing the legality of these documents, there should be no doubt of the validity of documents that have been remotely witnessed or notarized in accordance with a prior Executive Order issued by Governor Pritzker.

The law provides that the requirement of a notarial act or act of witnessing is satisfied if the act of witnessing or notarization is performed via two-way, real time audio-video communication that allows for direct contemporaneous interaction by sight and sound between the individual signing the document, the witness and the notary public. Additionally, any technology issues that may occur do not impact the validity or effect of any instrument or document signed. Those technology issues include, but are not limited to, internet connection problems, user error related to the use of technology, a corrupt file containing the recorded act, or other temporary malfunctions involving the technology used in an act of witnessing or a notarial act. This law remains applicable until 30 days after Governor Pritzker's emergency declaration regarding COVID-19 expires.

Trailer Bill for Illinois Trust Code

As we wrote about in the 2019 Advisory, the Illinois Trust Code became law in Illinois effective January 1, 2020. Practitioners are expecting a "trailer bill" within the next couple of months to correct the inevitable technical issues that have arisen since the implementation of the Illinois Trust Code and to clarify ambiguities therein. It is anticipated that the trailer bill will be introduced in the 2021 legislative session.

Fair Tax

On November 3, Governor Pritzker's Fair Tax proposal involving a constitutional amendment to permit a graduated-rate income tax and a new rate and bracket structure was rejected by Illinois voters.

Gearhart v. Gearhart, 2020 IL App (1st) 190042 (January 23, 2020)

In *Gearhart*, the grantor of a revocable trust executed two subsequent partial amendments altering how his estate should be distributed among his four children (plaintiff, defendant, and two other children). At issue is the trustee's interpretation of those amendments and the resulting distributions and actions.

The original trust agreement provided a formula for how distributions to the grantor's children should be calculated. The first amendment replaced that formula by declaring that "the trustee shall distribute the remaining trust principal and any undistributed trust income to the Grantor's descendants that survive him, per stirpes." The second amendment added two conditions to the per stirpes distribution, (1) noting that the trustee need not be obligated to distribute principal, and none of the grantor's children had the right to withdraw principal, while any obligations to the grantor's spouses (both ex-wife and surviving spouse) remain outstanding and (2) any child of the grantor without children of their own did not have a right to withdraw principal from the trust.

The trustee, one of the grantor's children, made distributions over the years to his siblings and himself from both trust principal and income in unequal amounts while obligations to the grantor's ex-wife were still outstanding. The two children not party to this case sought full distributions of their proportionate interests from the trust, which the defendant provided. When the remaining child sought a similar settlement, the trustee refused, claiming he was an income-only beneficiary as he was the only child of the grantor without kids of his own. The trustee also claimed that his interpretation of the trust documents aligned with the grantor's true intent.

The aggrieved sibling brought a claim seeking his proportionate interest in the trust and a claim of breach of fiduciary duty against the trustee. The trial court found that the trust agreement and subsequent amendments were clear from a plain text reading, removing the grantor's intent from consideration, and that each child of the grantor was entitled to a per stirpes distribution of the trust estate, once all obligations to the grantor's spouse were satisfied. The trial court further found that the trustee breached his fiduciary duty in several ways. First, when he failed to administer the trust according to its terms, specifically referencing the distributions of principal to the beneficiaries prior to the satisfaction of the obligations to the grantor's spouses. Second, when he distributed unequal amounts to beneficiaries despite the trust's requirement that all the grantor's children receive equal shares.

Here, the court made clear that **when the text of estate planning documents is clear, despite the perceived or known intent of the grantor, the court will rely on the text and largely disregard surrounding facts and circumstance.** This case also serves as a reminder that **a review of the terms of the trust and powers of the trustee with the successor trustees may avoid unintended consequences and misunderstandings down the road.**

Centrue Bank v. Voga, 2020 IL App (2d) 190108 (September 24, 2020)

In *Centrue Bank*, the grantor of a revocable trust executed a trust instrument allocating the residue of his property in equal shares to his four (4) children. Three (3) of the grantor's children were to receive specific parcels of property, though, which caused three (3) of the children to receive assets of greater value than the fourth (4th) child upon the finalized administration of the trust.

In conjunction with executing the revocable trust, the grantor also executed a durable power of attorney, which designated one of his children as his agent. The power of attorney provided a general statement authorizing his agent to amend, revoke and/or exercise any and all other powers the grantor could exercise under the terms of any trust for which the grantor was the trustor. Notably, though, the power of attorney failed to specifically name any

trust over which his agent would have the authority to exercise the power to amend or revoke. Notwithstanding the lack of a specific power to amend or revoke a specific trust, the grantor's agent attempted to amend the revocable trust to provide the fourth (4th) child (i.e., the child receiving fewer assets than the other three (3) children) with an amount of cash equal to the average fair market value of the real estate provided to the other children. One of the children contested the agent's purported exercise of power under the grantor's durable power of attorney on the grounds that the durable power of attorney did not sufficiently identify a trust over which the grantor's power would have the power to amend.

The appellate court held that **the grantor's agent could not lawfully amend the trust because the durable power of attorney failed to specifically mention that particular trust as required by Section 2-9 of the Illinois Power of Attorney Act.**

While not a surprising result, *Centrue Bank* is a good reminder that **an agent operating under a power of attorney must be cognizant of the law surrounding the exercise of the power and drafting formalities with respect to powers of attorney must be strictly followed.**

Raoul v. Dunston, 2020 IL App (5th) 190017 (February 20, 2020)

The *Raoul* case deals with the issue of stagnant estate planning documents and possible solutions to achieving desired tax results notwithstanding dated estate planning documents. In *Raoul*, the decedent executed estate planning documents in 2007 and died in 2014. Pursuant to the estate planning documents, all or a portion of the decedent's property was allocated to fund two (2) separate trusts — a Family Trust and a Marital Trust. Pursuant to the terms of the estate planning documents, the Family Trust was to be funded with the maximum amount that would result in no, or the least possible, federal estate tax (i.e., the estate planning documents had no specific provision taking into consideration any state estate tax). The estate plan was executed at a time when the federal estate tax and the Illinois estate tax mirrored each other. Subsequent to 2010, though, Illinois decoupled its estate tax exemption from the federal estate tax exemption. Importantly, the Family Trust gave the surviving spouse a lifetime power of appointment to appoint the trust assets among the decedent's children and their spouses, disqualifying the trust from qualifying for a QTIP election under section 2056(b)(7) of the Internal Revenue Code.

The decedent's Illinois estate tax return made an Illinois QTIP election in the amount of $1,050,687.84 of a tentative taxable estate of $5,050,687.84 (i.e., the amount of assets within the decedent's estate that would be subject to Illinois estate tax). Upon audit, the Illinois Attorney General determined that the Family Trust did not qualify for a QTIP election and assessed unpaid Illinois estate tax.

Over four (4) years after the decedent's death, the surviving spouse executed a written disclaimer of her lifetime power of appointment over the Family Trust. By its terms, the disclaimer was retroactively effective as of May 2, 2014, the date of decedent's death. Within a couple of months after executing the disclaimer, the surviving spouse and the decedent's children filed a motion to dismiss the Illinois Attorney General's complaint claiming that with the disclaimer, the Family Trust was now qualified to make a QTIP election.

Unlike the Internal Revenue Code, Illinois law does not have a timeliness requirement for a disclaimer to be "qualified." Instead, a disclaimer is barred under Illinois law only by:

1. **a judicial sale of the property, part or interest before the disclaimer is effected;**
2. **an assignment, conveyance, encumbrance, pledge, sale or other transfer of the property, part or interest, or a contract therefor, by the disclaimant or his representative;**
3. **a written waiver of the right to disclaim; or**
4. **an acceptance of the property, part or interest by the disclaimant of his representative.**

The appellate court found that the surviving spouse's disclaimer complied with Illinois law, and it was not subject to the other restrictions of federal law for purposes of an Illinois-only QTIP election. Essentially, the disclaimer executed over four (4) years after the decedent's death was effective to renounce the impermissible powers which would preclude a valid Illinois QTIP election.

This case certainly represents a win for the taxpayer in that the taxpayer found a method to have a trust qualify for the QTIP election. That said, though, had the decedent reviewed his estate planning documents within the four (4) years leading up to his death this issue would likely have been caught and addressed. This case represents the fact that **the law surrounding estate planning is ever-changing, and intermittent review of estate planning documents can circumvent issues that may arise as a result of old, stagnant documents.**

Carroll v. Raoul, 2020 IL App (3d) 180550 (March 13, 2020)

The *Carroll* case represents a simple legal holding regarding whether a decedent will receive a credit for estate taxes paid by another decedent. In *Carroll*, a decedent's estate claimed a prior transfer credit to reduce the estate's Illinois estate tax liability. Both of the decedent's parents died within ten (10) years prior to her death, and both parents paid both federal and Illinois state estate tax.

The decedent's executor claimed a credit on the decedent's Illinois estate tax return for prior estate taxes paid on property transferred from her parents' estates under the Illinois Estate Tax Act and sections 2011 and 2013 of the Internal Revenue Code. The Illinois Attorney General selected the Illinois estate tax return for audit and determined that under the Illinois Estate Tax Act, a prior transfer credit does not exist and assessed a balance due on decedent's Illinois estate tax return. The appellate court agreed with **the Illinois Attorney General, holding that the Illinois Estate Tax Act does not allow a prior transfer credit against Illinois Estate Tax when the taxes paid involve another decedent's estate.**

New York

2020 has been an active year for legislative reform in this area for New York State. A brief summary of the 2020 changes follows.

Estate Administration and Estate Taxation

The New York State basic exclusion amount for individuals dying on or after January 1, 2021, will be equal to the federal basic exclusion amount that was in place prior to the passage of the Tax Cuts and Jobs Act of 2017, indexed annually. While the 2021 exclusion amount has not been announced yet, the 2020 exclusion amount is $5.85 million.

There has been an increase in the value of an estate considered to be a "small estate" from up to $30,000 to up to $50,000 of personal property in order to provide greater access to New York's small estate $1 "do-it-yourself" program available through the court, allowing more lower and middle class New Yorkers access to this program.

Remote Notarization and Remote Witnessing

In order to provide relief to estate planners and individuals seeking estate planning services, a number of Executive Orders were signed that authorize remote notarization and remote witnessing to allow estate planning documents, which have traditionally been signed in person, to be executed remotely using video teleconferencing techonology.

Pursuant to New York Executive Order Number 202.7, and subsequent extensions thereto, documents may be remotely notarized using video teleconferencing technology. In order for the remote notarization of a document to be valid, both the signor and the Notary Public must be present within the State of New York, and the following requirements must be met: (1) if the person seeking the Notary Public's services is not personally known to the Notary Public, such person must present valid photo identification to the Notary Public during the video conference;

(2) the video conference must allow for direct interaction between the person and the Notary Public; (3) the person must affirmatively represent that he or she is physically present within the State of New York at such time; (4) the person must transmit by fax or other electronic means a legible copy of the signed document directly to the Notary Public on the same day that it was signed; (5) the Notary Public may notarize the transmitted copy of the document and transmit the same back to the person; and (6) the Notary Public may repeat the notarization of the original signed document as of the date of execution, provided the Notary Public receives such original signed document together with the electronically notarized copy within 30 days after the date of execution.

Pursuant to New York Executive Order Number 202.14, and subsequent extensions thereto, documents, including estate planning documents such as wills, may be remotely witnessed using video teleconferencing technology. In order for the remote witnessing of a document to be valid, the following requirements must be met: (1) the person requesting to have his or her signature witnessed must present valid photo identification if not personally known to the witnesses; (2) the video conference must allow for direct interaction between the person, the supervising attorney and the witnesses; (3) the witnesses must receive a legible copy of the signature page on the same day it was executed; (4) the witnesses may sign a transmitted copy of the signature page and transmit the same back to the person; and (5) the witnesses may repeat their signature on the original signed document as of the date of execution provided the witnesses receive such original signed document within 30 days after the date of execution.

Fiduciary Commissions

Donees of powers in trust (powers in trust to manage property vested in an incapacitated person) and donees of powers during minority (a power during minority to manage property vested in an infant) shall receive commissions under the same guidelines governing commissions paid to trustees, rather than the guidelines governing commissions paid to fiduciaries other than trustees.

Real Estate

The enactment of the Uniform Partition of Heirs Property Act prevents predatory real estate speculators from taking advantage of individuals owning a stake in residential property owned by heirs, by purchasing an heir's stake in the residential property and using such ownership stake to file a partition action to dispossess the other family members of the property through a forced sale, oftentimes at a price significantly below the fair market value of the property.

Child-Parent Security Act

As part of the 2020-2021 Executive Budget, New York State established the Child-Parent Security Act (CPSA). The significant purpose of CPSA is to legally establish a child's relationship to the child's parents, where the child is conceived through artificial reproduction. CPSA: (1) establishes legal rights of intended parents (an individual who manifests an intent to be legally bound as the parent of a child resulting from artificial reproduction) who use a third-party to conceive a child from the moment of the child's birth; (2) legalizes compensated gestational surrogacy in New York, provided, however, the surrogacy arrangement meets the requirements provided for in CPSA; and (3) establishes new procedures for obtaining a judgment of parentage through gamete or embryo donation or through the use of a gestational surrogate.

CPSA distinguishes between a donor of genetic material (a participant) and the intended parent of a child. CPSA outlines the procedures by which the intended parents of a child can obtain a judgment of parentage of the child prior to or after the birth of a child, including by signing a voluntary acknowledgement of parentage form at the hospital during a child's birth for the non-genetic intended parent, but such judgment is not effective until the birth of the child. Additionally, CPSA adds a procedure through which a participant can obtain a judgment terminating

any potential parentage rights of the participant. A judgment of parentage or nonparentage provides for clarity as to who the child's parents are from the moment of birth and establishes a legally binding financial and parental responsibility of the intended parents over the child.

CPSA enacts a Surrogate's Bill of Rights that serves to protect individuals acting as surrogates within New York State. The Surrogate's Bill of Rights provides that the surrogate has the right to: (1) make all health and welfare decisions regarding themselves and their pregnancy; (2) be represented throughout the contractual process and the duration of the surrogacy agreement and its execution by independent legal counsel of the surrogate's choosing that is paid for by the intended parent(s); (3) have a comprehensive health insurance policy that is paid for by the intended parent(s); (4) reimbursement for all co-payments, deductibles and any other out-of-pocket medical care associated with pregnancy, childbirth, postnatal care, a stillbirth, a miscarriage or a termination of the pregnancy by the intended parent(s); (5) obtain a health insurance policy that covers behavioral health care and covers the cost of psychological counseling to address issues resulting from the surrogate's participation in a surrogacy that is paid for by the intended parent(s); (6) be provided with a life insurance policy that provides a minimum benefit of $750,000, or the maximum amount the person acting as a surrogate qualifies for if less than $750,000, and has a term that extends throughout the duration of the expected pregnancy and for 12 months after the birth of the child, a stillbirth, a miscarriage or a termination of pregnancy, that is paid for by the intended parent(s); and (7) terminate a surrogacy agreement prior to becoming pregnant.

CPSA also provides clarification regarding stored embryos. Spouses or partners with joint dispositional control of the stored embryos will have the ability to enter into an agreement to transfer legal rights and dispositional control of any stored embryos to the other spouse or partner. Such an agreement must be in writing, and each person must be represented by separate legal counsel. If the couple is married, such transfer can only occur after the couple is divorced. After the transfer of dispositional control, the transferor is not a parent of any child born thereafter from the stored embryos, unless they sign a writing, prior to the medical embryo transfer, stating that they want to be a parent of a child born of such embryos.

Regarding children born after the death of a genetic parent, CPSA allows for the decedent to be recognized as the child's parent, provided, however, the deceased genetic parent had signed a record consenting to be a parent if assisted reproduction were to occur posthumously during the decedent's lifetime.

<u>Birth Certificates of Adopted Persons</u>

Adopted persons who reach the age of 18 years, or the direct line descendants or legal representatives of deceased adopted persons, may obtain a certified copy of the adopted person's original long form birth certificate without the requirement of a judicial hearing. The adopted person, or the direct line descendants or legal representatives of a deceased adopted person, will be able to access all of the information included on the birth certificate, including the identifying information of any listed birth parents.

<u>Health and Medical Decisions for Children</u>

Any person with a lawful order of custody of a child may make medical decisions for such child, including giving any needed consents for a child's protection, education, care and control. Previously, only a parent or legal guardian could make health and medical decisions for a child.

<u>Not-for-Profit Organizations</u>

Not-for-profit organizations, for the duration of COVID-19, may conduct certain practices and procedures relating to board meetings remotely by using electronic and/or audio-visual technology. Not-for-profit organizations, religious institutions and cooperatives may hold meetings of shareholders, members, trustees and other similar officers through remote communications, to the extent that the board of such organization implements reasonable guidelines and procedures for effective electronic participation.

Uniform Voidable Transactions Act

The enactment of the Uniform Voidable Transactions Act (UVTA) replaces the 1925 Fraudulent Conveyances Act and creates greater consistency, efficiency and predictability regarding property that is exempt from creditors. The enactment of the UVTA makes New York law consistent with federal bankruptcy laws, as well as improves upon the provisions of New York law for determining insolvency. The UVTA also serves to clarify terminology, choice-of-law determinations, and the burden of proof of each party.

E-Filing

Pursuant to an Administrative Order of the Chief Administrative Judge of the Courts dated June 9, in courts and case types approved for electronic filing through the New York State Courts Electronic Filing System (NYSCEF), all represented parties must commence new matters or proceed in pending matters exclusively through electronic filing on NYSCEF. Pursuant to an Administrative Order of the Chief Administrative Judge of the Courts dated July 10, electronic filing is now mandatory for all probate and administration proceedings, and miscellaneous proceedings relating thereto, in a majority of New York State counties. However, as a result of the Administrative Order dated June 9, probate and administration proceedings, and miscellaneous proceedings related thereto, must be electronically filed, even in voluntary jurisdictions, if the parties to the matter are represented by counsel.

Suspension of Statute of Limitations

Pursuant to New York Executive Order Number 202.8, issued March 20, and subsequent extensions thereto, the time limits prescribed by any procedural laws, including, but not limited to, the Civil Practice Law Rules, Family Court Act, Surrogate's Court Procedure Act and the Uniform Court Acts, were suspended for the commencement, filing or service of any legal action, notice, motion or other process or proceeding through November 3. As of November 4, the suspension of any time limits for the commencement, filing or service of any legal action, notice, motion, or other process or proceeding for civil cases was no longer in effect, except, however, all suspensions of the Family Court Act remained in effect until November 18, and thereafter have continued to remain in effect for those juvenile delinquency matters not involving a detained youth and for those child neglect proceedings not involving foster care.

Pending Changes to Statutory Short Form Power of Attorney

As of the time of writing, there is a bill that has passed the New York Senate and the New York Assembly, but has yet to be signed by Governor Cuomo regarding changes to the statutory short form power of attorney and other powers of attorney for purposes of financial and estate planning, as well as the statutory gifts rider.

The purpose of the proposed changes is to address the myriad complaints and complexities of preexisting law affecting powers of attorney that have been vexing practitioners since its overhaul in 2008. Specifically, this bill would: (1) simplify the current power of attorney form which is complex and prone to improper execution; (2) allow for substantially compliant language rather than the exact wording requirement of current law which has proven unduly burdensome; (3) provide safe-harbor provisions for those who, in good faith, accept an acknowledged power of attorney without actual knowledge that the signature is not genuine; (4) provide for a mechanism to receive and address a rejection of a power of attorney and to allow sanctions for those who unreasonably refuse to accept a valid power of attorney; (5) make technical amendments to allow a person to sign at the direction of a principal who is unable; (6) clarify an agent's obligation to keep records or receipts; (7) clarify the agent's authority with regard to financial matters related to health care, including, notwithstanding any law, to receive information from health care providers and health plans; and (8) expand the agent's power to make gifts in the aggregate in a calendar year from $500 to $5,000 without requiring a modification to the form or the execution of a statutory gifts rider.

North Carolina

<u>Temporary Emergency Video Notarization</u>

Pursuant to Session Law 2020-3 and Session Law 2020-74, all Notaries Public may perform emergency video notarizations until March 1, 2021. This law was scheduled to expire on August 1 but was extended to March 1, 2021 by Session Law 2020-80.

This temporary authorization allows virtual notarizations of estate planning documents but specifically excludes video notarizations of documents under Article 20 of Chapter 163 of the General Statutes (including absentee ballots) and Proofs or Verifications as defined in N.C.G.S. 10B-3(28).

The requirements for emergency video notarization are as follows:

1. The parties must use video conference technology that allows for direct, real-time interaction between the principal signer(s) and the Notary Public. No pre-recorded video or audio is allowed.
2. The audio-video technology quality must allow for clear visual observation of the face of each participant and clear visual observation of any identification being provided, as well as audio clear enough that each participant can hear and understand all parties.
3. Personal knowledge of identity may be used for identification purposes. In lieu of personal knowledge, the principal signer(s) must have an acceptable form of identification, which they will hold up to the video recording device long enough for the Notary Public to confirm that it is a form of identity that meets the requirements of satisfactory evidence of identity, which includes at least one document that meets all the following requirements: (a) North Carolina driver licenses and State ID cards that are current or not expired before March 1 (other forms of identification must be current or not expired before March 10); (b) issued by a state, federal or recognized tribal government agency; (c) has a picture of the principal's face; and (d) has a physical description and signature of the principal.
4. Each principal signer must indicate that they are physically located in the state of North Carolina and identify the county where he or she is located at the time of the notarial act. The Notary Public must use video conference technology to observe each principal sign each document to be notarized. The principal must state what documents are being signed for the notarial record. In the case of an oath or affirmation, the Notary Public must administer the oath or affirmation to the affiant in real time over the live video feed.
5. If an original wet-signed notarization on an original wet-signed document is not required, the principal or principal's designee must transmit by fax or other electronic means a legible copy of the signed document directly to the Notary Public on the same day the document was signed. For documents transmitted by fax or electronic means, the Notary Public must notarize the signature on the transmitted copy of the document and transmit the notarized document back to the principal or principal's designee on the same day.
6. If an original wet-signed notarization on an original wet-signed document is required, the principal or principal's designee must transmit a legible copy of the signed document by fax or other electronic means to the Notary Public on the same day on which the document was signed <u>and</u> also deliver the original signed document to the Notary Public by mail or other physical method. The Notary Public must compare the original document with the document transmitted by fax or other means. If the documents are determined to be the same, the Notary Public shall notarize the wet-signature on the original document and date the notarial act as of the date of the act observed using video conference technology and promptly transmit the original wet-notarized original document to the principal or principal's designee by mail or other physical delivery as directed by the principal.

7. The Notary Public must record the details of the emergency video notarization transaction in a notary journal, and the journal must be retained by the Notary Public for at least 10 years (it may be maintained in electronic form). The Notary Public must keep in the journal in a secure location and must not allow another person to make entries. A Notary Public may surrender the journal to the Notary Public's employer upon termination of employment, but the Notary Public must also keep and maintain an accurate copy of the journal. At a minimum, the Notary Public is required to include the following information in a journal for each emergency video notarization:
   a. Time of day when the Notary Public observed the signing of the document by each principal and was presented with the principal's acceptable form of identification;
   b. Date of the completion of the emergency video notarization notarial certificate;
   c. Last and first name of the principal signer;
   d. Type of notarial act performed;
   e. Type of document notarized or proceeding performed;
   f. Type of acceptable form of identification presented including, if applicable, issuing agency and identification number on the identification presented;
   g. Type of video conference technology used during the emergency video notarization;
   h. Statement that the Notary Public and each principal signer could see and hear each other; and
   i. Whether other persons were present in the room with the principal signer(s) and if so, the name of that person(s).

   The Notary Public may want to include other documentation in the journal, such as:
   a. An electronic recording using the video conference technology's recording and storage services, a video recording of the video conference using an independent recording device like a smart phone, or electronically-saved screen shots of the transaction that clearly show the face of each participant, any identification presented, and the notarized document(s). This may be required by some interested parties to transactions (i.e. title insurance companies, mortgage lenders, etc)
   b. How the Notary Public confirmed that the document signed by the principal signer(s) during the emergency video notarization is the same as the one presented to the Notary Public for the notarial certificate.
8. A Notary Public may decline to perform a notarial act if the Notary Public is not satisfied that the principal's identity has been satisfactorily proven.
9. An emergency video notarization does not change any originality verification requirements for recording with Registers of Deeds, Clerks of Superior Court, or other government or private office in North Carolina.

In addition to any notarial certificate required by law, the party preparing the notarial certificate must include the following language in the certificate:

1. I signed this notarial certificate on (<u>date</u>) according to the emergency video notarization requirements contained in N.C.G.S. 10B-25.
2. The North Carolina county in which the Notary Public was located during the emergency video notarization.
3. The North Carolina county in which the principal signer(s) stated they were physically located during the emergency video notarization.

No Witnesses Temporarily Required for Valid Execution of Health Care Power of Attorney and/or Living Will (Expired August 1)

Pursuant to Session Law 2020-3, until August 1, Health Care Powers of Attorney or Declarations of a Desire for a Natural Death, which normally require two independent witnesses, could be validly executed if properly acknowledged before a Notary Public. The Notary Public acknowledgement for such documents needed to contain a statement indicating that the advance directive was signed in accordance with the procedures of N.C.G.S. 32A-16.1 (health care powers of attorney) or N.C.G.S. 90-321.1 (natural death declarations). However, under current law, Health Care Powers of Attorney and Living Wills once again require witnesses as under prior law.

WE CAN HELP

We hope that this advisory helps you with your year-end estate and gift tax planning and also provides you with some interesting ideas to consider for the future. As always, the Private Wealth practice stands ready and able to assist you with these matters at any time.

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