

GIBSON&PERKINS

INCOME TAX AND ESTATE TAX UPDATE

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CORPORATE LAW

Decision Holding Corporate Transparency Act Unconstitutional Appealed

The U.S. Justice Department (DOJ) appealed a federal court decision that held the Corporate Transparency Act (CTA), P.L. 116-283, which requires the reporting of beneficial ownership information (BOI) by businesses, is unconstitutional.

On Monday, the DOJ filed [its appeal](#) of the March 1 decision by a federal district court in Alabama to grant the plaintiffs' motion for summary judgment regarding the constitutionality of the law in the case of *National Small Business United v. Yellen*, No. 5:22-cv-1448-LCB (N.D. Ala. 3/1/24).

The holding affects only the plaintiffs, which include the 65,000 businesses that were National Small Business Administration (NSBA) members as of March 1.

Todd McCracken, the NSBA president and CEO, said the NSBA welcomes the appeal because he expects the courts to agree that the act is unconstitutional.

"If Congress does not repeal the CTA, eventually the Supreme Court will need to address this issue as well and strike down the statute for the entire United States," he said Tuesday in a statement.

Under the act, which Congress passed in 2021 as an anti-money-laundering initiative, reporting companies, which are defined as corporations, limited liability companies (LLCs), and similar entities, must disclose the identity and information about beneficial owners of the entities. For new entities incorporated after Jan. 1, 2024, reporting companies must also disclose the identity of "applicants" — defined as any individual who files an application to form a corporation, LLC, or other similar entity.

Reporting companies are required to provide information about both the companies and their beneficial owners and applicants, including full legal name, address, state or tribal jurisdiction of formation, IRS taxpayer identification number, birth date, and other details. Willful violations are punishable by a fine of \$591 a day, up to \$10,000, and two years in prison with similarly serious penalties for unauthorized disclosure.

Treasury's Financial Crimes Enforcement Network (FinCEN), which administers the CTA, estimates that BOI reporting regulations apply to 32.6 million entities with 5 million to be added each year through 2034.

[AICPA response](#)

In a statement after the federal court opinion, the AICPA said that small businesses should continue to file BOI reports. The statement also said that the AICPA continues to push for suspension of the BOI reporting rule.

ESTATE TAX UPDATE

Biden Tax Proposals

President Biden has lots of tax proposals. They are dead on arrival in an election year. However, taxes will be a top issue in 2025.

Biden is starting to lay the groundwork ahead of a looming fight on the fate of the tax changes in former President Trump's 2017 tax reform law, many of which will expire at the end of next year.

We'll look at one of Biden's thorniest ideas. Currently, a decedent's unrealized gains aren't hit with income tax at death, and heirs get a step-up in basis in inherited assets equal to fair market value. Biden wants to end the effects of stepped-up basis for wealthy individuals.

His proposal generally doesn't adopt carryover basis, by which the heir would take the same federal tax basis in the inherited assets as the decedent.

It would instead treat death as a realization event for income tax purposes... essentially a deemed taxable sale of the decedent's capital assets at fair market value, with capital gains and losses reported on the decedent's final income tax return. The heirs would continue to get a fair-market-value basis in assets they receive.

Gifts would also be treated as a realization event for income tax purposes. Unlike current law, the donees would take a fair market value in gifted property.

There is a \$5 million lifetime gain exclusion. Plus other exceptions: Property left to a surviving spouse wouldn't be taxed until that spouse's death, but the spouse would take a carryover basis in those assets. Charitable donations would be exempt. Family-owned businesses would escape tax if the heirs run them. The existing gain exclusion of \$250,000 (or \$500,000) on sales of primary residences would continue to apply. Gain on tangible personal property left to heirs, such as household furnishings and personal effects, would be exempt from the regime. Also, heirs can opt to pay the decedent's income tax over 15 years on nonliquid assets.

Let's illustrate the current rules and Biden's proposal with a simple example: When Amy's dad dies, she inherits stock that her dad bought years ago for \$300,000 that is now worth \$7 million. Under current law, the \$6.7 million stock appreciation isn't subject to income tax, and Amy takes a \$7 million tax basis in the shares. Six years later, Amy sells the stock for \$7.5 million. Amy pays tax in the year of sale on her \$500,000 gain. Under Biden's proposal, the stock would be deemed sold upon the dad's death. Assuming he hadn't used up any of his \$5 million exclusion, the dad's final federal income tax return would reflect gain of \$1.7 million (\$6.7 million – \$5 million exclusion) and would show tax due from the deemed sale.

Biden also calls for nearly doubling the capital gains tax for upper-incomers by taxing gains as ordinary income to the extent taxable income exceeds \$1 million. His realization regime detailed above would act as

a backstop, so that taxpayers subject to high tax rates while alive wouldn't hold onto assets until death to escape tax.

IRS Provides Guidance on Some Retirement Benefit Changes Under the SECURE 2.0 Act

In Notice 2024-2, 2024-2 IRB (Jan. 8, 2024), the IRS provided guidance in Question & Answer format regarding several retirement benefit changes under the SECURE 2.0 Act, Division T of the Consolidated Appropriations Act, 2023, Pub. L. 117-328, 136 Stat. 4459 (2022).

Of primary interest to estate planners will be the new exception from the ten percent additional tax on premature plan distributions (Code Sec. 72(t)(1)) for distributions made to a terminally ill individual.

Among the questions addressed in the Notice are: (a) who qualifies as a physician for purposes of certifying that the employee has a terminal illness; (b) what must be included in a physician's certification of a terminal illness; (c) can the certification of a terminal illness be made after the employee already receives a distribution; and (d) what limit exists on the size or number of terminally ill individual distributions.

There's some confusion about the increase in the RMD age to 73.

This change, enacted in the SECURE 2.0 law, applies only to owners of IRAs, 401(k)s and the like, who turned 72 after 2022. Individuals who turned 73 last year were required to first start taking RMDs for 2022, when they turned 72. Because of the transition from age 72 to 73, no one could opt to delay their first RMD to April 1, 2024. Our item in the Feb. 29 Letter was incorrect, and we apologize.

Addition of Tax Reimbursement Clause to Grantor Trust is Taxable Gift from Beneficiaries to the Grantor

In CCM 2023252018 (Dec. 29, 2023), the IRS Chief Counsel advised that when the beneficiaries of an irrevocable grantor trust agreed to a modification to permit, but not require, the trustee to reimburse the grantor for income taxes incurred on trust income, they made a taxable gift to the grantor.

The IRS distinguished Rev Rul 2004-64, 2004-2 CB 7, which stated that a trustee's reimbursement of the grantor for the income tax paid by the grantor on a grantor trust was not a gift by the trust beneficiaries, where the distribution was either required or authorized by the terms of the governing instrument. In the CCM, however, the grantor's entitlement to discretionary distributions was the result of a modification to an existing trust, rather than a provision of the original trust instrument or state law.

The IRS also acknowledged that this memorandum differs from the conclusion reached in PLR 201647001 (Aug. 18, 2016), which no longer reflects the position of the Chief Counsel.

Supreme Court Will Decide How Life Insurance Funding for a Stock Redemption Affects Estate Tax Values

In *Connelly v. United States*, 70 F3d 412, 2023 WL 3769233 (8th Cir. 2023), cert. granted, 2023 WL 8605743, No. 23-146 (S.Ct. Dec. 13, 2023), the Supreme Court has granted certiorari to review the decision of the Court of Appeals for the Eighth Circuit, which held that the estate tax value of closely-held

stock that was the subject of a redemption buy-sell agreement, must be increased to reflect the proceeds of a company-owned life insurance policy used to finance the redemption. The Eighth Circuit's opinion conflicts with the opinion of the Eleventh Circuit in *Estate of Blount v. Comm'r*, 428 F.3d 1338, 1342–43 (11th Cir. 2005), *aff'g in part, rev'g in part*, T.C. Memo. 2004-116.

Below-Value Purchase of Corporate Shares Resulted in Taxable Gifts

In *Huffman v. Comm'r*, T.C. Memo. 2024-12 (Jan. 31, 2024), the Tax Court held that a couple made taxable gifts to their son when he exercised rights under buy-sell agreements to buy shares in a controlled company for substantially less than their value on the date of the sale, and that the buy-sell agreement did not set gift tax values under Code Sec. 2703. The buy-sell agreements were entered into between the taxpayer and a corporation owned by his mother and a revocable trust created by his parents. The agreement valued the shares at \$5 million at the time of the sale, when their fair market value was over \$20 million. The court also held that the buy-sell agreement did not set gift tax values under Code Sec. 2703 because the terms of the agreements were not comparable to those entered into between unrelated persons.

PENNSYLVANIA DEVELOPMENTS

In re Lincoln Fire Company: Importance of Nonprofit Corporation's Purpose and By-Laws, Inapplicability of Cy Pres Doctrine to Distribution of Assets upon Dissolution

In re Lincoln Fire Company — A.3d --, 479 C.D. 2022, 2024 WL 158111 (Pa. Commw. 2024) Orphans' Court properly denied petition for Voluntary Dissolution of Volunteer Fire Company insofar as Fire Company requested court approval of distribution of assets to organizations that did not maintain and support a fire company or provide fire services, improperly applied Cy Pres doctrine where voluntary fire company retained ability to propose distribution to other organizations that maintained and supported a fire company or provided fire services.

Calihan Estate (O.C Div Allegh.)

Upon consideration of a motion for reconsideration, the trial court concluded that while 24 P.S 6901.316, which exempts only Pennsylvania 529 Plans and not 529 Plans established in other states from Pennsylvania inheritance tax, is unconstitutional as written, the statute shall be interpreted so as to not violate the Pennsylvania Constitution, as follows: all qualified State tuition programs, as defined by section 529 of the Internal Revenue Code of 1986, as amended, shall be treated the same as a Tuition Account Program Contract.

INCOME TAX

Taxation of NILs

Since the Supreme Court ruled that college athletes can be compensated for their name, image and likeness, many student athletes have inked deals with firms to act as brand sponsors, touting products and services in commercials, advertisements and on social media. Many of these deals are through NIL collectives. NIL income is taxable, whether the athlete is paid in cash or in free products or services. Most

student athletes with NIL income are considered self-employed, so you'll also owe self-employment tax on your net earnings. Keep records of expenses you incur in generating NIL income so that you can deduct them on Schedule C. Also, look into whether you will be required to pay quarterly estimated taxes.

Want to know what revenue agents look for when they audit partnerships?

IRS has a job aid for examiners to follow. It sets forth issues to focus on, sample language for information document requests, and interview questions. Agents use the guide to help select issues and to save time in the exam process. We guess that another reason for this guide is to reduce the no-change exam rates. In recent years, nearly 50% of partnership audits have resulted in no change to the amount of taxes.

Lottery Winnings Taxable

The current federal income tax withholding rate is 24%. Plus, you will be in the 37% tax bracket if the jackpot pushes your 2024 taxable income over the \$609,350 mark...\$731,200 for joint filers. So be ready for the big tax hit. In most cases, your state will take a nice chunk of your winnings, too. State withholding rates range from 2.9% to over 8%. In Mich., where the winning ticket for the New Year's Day \$842 million Powerball was bought, the rate is 4.25%. Alaska, Calif., Fla., Nev., N.H., S.D., Tenn., Texas, Wash. and Wyo. don't tax winnings.

Winnings from online sports betting are taxable as gambling income, whether you are playing in fantasy sports leagues, in which cash prizes are based on the performance of professional athletes, or you are betting on the outcome of a particular event, such as the Super Bowl or a basketball game. You report winnings on line 8b of Schedule 1 of the 1040. Losses are deductible only if you itemize on Schedule A and only to the extent of your reported winnings. Some gamblers can file Schedule C if their gambling activity is extensive enough to rise to the level of a trade or business, but this can be a difficult hill to climb.

The COVID-19-related employee retention tax credit is rife with fraud.

This temporary payroll tax credit was enacted by lawmakers in 2020 to help employers whose operations were fully or partly halted, or whose gross receipts fell significantly, during the height of the pandemic. Firms have swamped IRS with Form 941-X filings seeking refunds for prior-year employment taxes and any excess refundable ERTCs. Because of fraud, IRS stopped processing Forms 941-X claiming ERTCs last Sept. to give it time to implement protections and safeguards against false ERTC filings.

Here's an extreme example of alleged ERTC tax fraud by a prisoner. The U.S. Attorney's office in Calif. filed a criminal complaint against a gang member in prison for first-degree murder and three other people on the outside. The complaint alleges that the prisoner initiated and supervised a tax fraud scheme that involved the filing of over 400 Forms 941-X, claiming more than \$550 million in false ERTC refunds. On a side note, this same prisoner is also being charged with leading an interstate drug-trafficking scheme involving methamphetamine.