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This periodic publication highlights developments and trends in trusts and estates from a practical viewpoint based on IPB's experience. This issue focuses on legislative and regulatory developments. Our goal is to share our insights with wealth and philanthropy advisors, corporate fiduciaries, accountants and other advisors in a way that is accessible and actionable. We welcome feedback and additions to our mailing list (*ipb@ipbtax.com*).

ANTI-CLAWBACK REGULATIONS

By Kasey Place

As part of the 2017 Tax Cuts and Jobs Act, the estate and gift tax exclusion amount (also known as basic exclusion amount or "BEA") was temporarily doubled from $5 million inflation adjusted to $10 million inflation adjusted. IRC § 2010(c)(3)(C). The increased exclusion will sunset after 2025. *Id.*

Initially there was concern among estate planners that clients who used their increased exclusion and lived past 2025 would not benefit from it. Because of how the estate tax has historically been calculated, they feared that such gifts would be "clawed back" into the client's estate and subjected to tax at death.

Happily, Treasury enacted final regulations on November 22, 2019, eliminating that risk. T.D. 9884.

Problem

In simplified terms, since 1976 the estate tax has been calculated by (i) adding lifetime gifts to the taxable estate, (ii) reducing the sum by the exclusion amount allowable at death and (iii) applying the applicable tax rate (presently 40%). However, if the exclusion amount allowable at death is less than was allowable at the time of the lifetime gifts, this formula could have unintended consequences.

Example #1. On the urging of her estate planning attorney who warned her that the increased exclusion amount is "use it or lose it", Moira made a $9 million gift to her daughter in 2020. Moira died in 2026 with a taxable estate of $3 million. At the time of Moira's death, the exclusion amount was $6 million. Absent changes to the above-described formula, Moira's estate would owe estate tax of $2.4 million (40% of ($9 million + $3 million - $6 million)). This is the same amount that Moira's estate would owe if she had never made the 2020 gift (assuming the value of the gifted assets hasn't changed). Said differently, other than removing post-gift appreciation from her estate, Moira would not benefit from using the increased exclusion amount during life.

Solution

Recognizing the foregoing problem, Treasury amended Treas. Reg. § 20.2010-1 to eliminate the potential clawback. The exclusion amount allowable at death will now be the greater of (i) the date-of-death exclusion amount or (ii) total exclusion used during life. The Preamble to Treas. Reg. § 20.2010-1(c) states as follows:

> The final regulations adopt the special rule provided in the proposed regulations in cases where the portion of the credit against the estate tax that is based on the BEA is less than the sum of the credit amounts attributable to the BEA allowable in computing gift tax payable within the meaning of section 2001(b)(2). In that case, the rule provides that the portion of the credit against the net tentative estate tax that is attributable to the BEA is based upon the greater of those two credit amounts. The rule thus would ensure that the estate of a decedent is not inappropriately taxed with respect to gifts that were sheltered from gift tax by the increased BEA when made.

Example #2. Assume the facts are the same as in Example #1, above. Because the amount of exclusion Moira used during life ($9 million) exceeds the date-of-death exclusion amount ($6 million), the exclusion amount allowable under Treas. Reg. § 20.2010-1(c) is $9 million. Moira's estate will, therefore, owe estate tax of $1.2 million (40% of ($9 million + $3 million - $9 million)). Unlike in Example #1, Moira's heirs will benefit from the fact that she used some of her increased exclusion before 2026.

The final regulations provide welcome certainty to estate planners who will be urging their clients to make large gifts before 2026.

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RECENT DEVELOPMENTS: CRYPTOCURRENCY

By Robert Daily

John Oliver said that cryptocurrency is "everything that you don't understand about money combined with everything you don't understand about computers." More precisely, a cryptocurrency is a type of virtual currency that can be used either as a medium of exchange (e.g., U.S. Dollar) or as a storage of value (e.g. numismatic gold coins). According to CoinMarketCap, over twenty cryptocurrencies are valued at over one billion dollars, with Bitcoin now valued at over $184 billion. In response to the rapid rise in value and the perceived threat of taxpayers not reporting their cryptocurrency transactions, the IRS recently released some guidance.

Background: Although each cryptocurrency is different, the basic structure is the same: a particular piece of property (the unit of cryptocurrency) is recorded on a distributed ledger (a blockchain), which is validated by computer network participants (nodes). Unlike fiat currency, like the U.S. dollar, that is issued and backed by a central government, cryptocurrency is not issued or overseen by any central organization. Instead, the cryptocurrency is controlled by its protocol, which sets out the terms for the software (e.g., how a transaction will be verified by nodes, how many nodes are required to change the protocol, and how large a block in the blockchain can be). Each block in the blockchain is validated by the nodes, and once validated, attaches to the previous block. No one can change to the block after it attaches to the blockchain. Anyone is free to buy or sell a cryptocurrency or verify a transaction according to the protocol of that cryptocurrency. Additionally, many cryptocurrencies, like Bitcoin, are open source, meaning that the cryptocurrency protocol can be modified by anyone. This decentralization means that developers or nodes may disagree with each other and change the structure of the cryptocurrency by creating a "fork."

2019 Income Tax Reporting Obligation: Starting with the 2019 tax year, taxpayers will need to state, under penalties of perjury, whether they engaged in a transaction involving cryptocurrency. The instructions to Schedule 1 of Form 1040 clarify that a transaction includes all of the following:

- The receipt of virtual currency for free (without providing any consideration), including from an airdrop or following a hard fork.
- An exchange of virtual currency for goods or services;
- A sale of virtual currency; and
- An exchange of virtual currency for other property, including for another virtual currency.

Revenue Ruling 2019-24: In October 2019, the IRS released a revenue ruling that describes two situations involving a cryptocurrency that has undergone a fork. In Situation 1, a cryptocurrency experienced a "hard fork" that resulted in a new blockchain but did not result in any additional unit of cryptocurrency. Such a scenario can occur when there is a security problem with a cryptocurrency and developers want to fix the problem by starting a new chain so that the old, less secure chain dies off. The IRS said that this form of hard fork is not taxable.

Situation 2 involved a "hard fork followed by an airdrop." The IRS said that an airdrop is "a means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple addresses." Before the hard fork, the taxpayer only had one unit of cryptocurrency A. After the hard fork, the taxpayer had one unit of cryptocurrency A and one unit of cryptocurrency B. The IRS said that if an airdrop follows a hard fork, a taxpayer has gross income if the taxpayer has dominion and control over the cryptocurrency that was airdropped.

The IRS also released a number of FAQs along with the revenue ruling that, among other things, clarified the following income tax consequences of cryptocurrencies:

- <u>Cryptocurrency is Property</u>: Cryptocurrency is treated like any other intangible asset, so the usual property rules regarding holding period and capital gains treatment similarly apply.
- <u>Donations</u>: Cryptocurrency can be donated to charity, provided that the cryptocurrency holder receives a qualified appraisal to substantiate their donation.
- <u>Bona Fide Gift</u>: Cryptocurrency can be gifted, provided that the donor provides the gift out of "detached and disinterested generosity." The donee would not recognize income from the gift.
- Nevertheless, several unsettled areas remain, including the tax treatment of contentious hard forks (like the hard fork of Bitcoin and Bitcoin Cash in 2018) and the situs of cryptocurrency assets.

Tax Planning Considerations: If you have a client who holds appreciated or depreciated cryptocurrency, consider talking to an IPB attorney about tax planning strategies:

- CRTs: Diversify cryptocurrency holdings by placing appreciated cryptocurrency into a charitable remainder trust.
- *Losses*: Consider whether the cryptocurrency is a "security" and whether the wash sale rules apply.
- *Situs*: If a cryptocurrency is not U.S. situs, consider whether U.S. resident has FBAR filing obligations or whether non-citizen non-residents can gift those units of cryptocurrency.
- *Pre-2019 Income Tax Filing obligations*: Determine whether your client exchanged cryptocurrency before 2019 and did not report the transaction on a tax return. Also consider whether section 1031 treatment applies if your client exchanged one cryptocurrency for another before 2018.
- *Donations*: Obtain a qualified appraisal and file a Form 8283 to ensure that you can get an income tax deduction for donation of cryptocurrency to a qualified charity.

MARYLAND'S NEW ELECTIVE SHARE STATUTE

By Linda Kotis

Overview: On October 1, 2020, Maryland's elective share law will fundamentally change. As under the current law, a surviving spouse who rejects what was given to him under his spouse's Will still will be able to elect against the deceased spouse's estate and take the same one-third (1/3) of the estate if the deceased spouse had descendants, and a one-half (1/2) share if there were none. A key difference in the new law, however, is that "the estate subject to election" will now be based upon the concept of the "augmented estate." The new law provides both challenges and opportunities for planning.

Description of Augmented Estate: Under Maryland's new law, the property subject to election will include (i) the probate estate; (ii) revocable trusts; (iii) all property over which the decedent held a qualifying power of disposition before death; (iv) all qualifying joint interests of the decedent; (v) all qualifying lifetime transfers made by the decedent; and (vi) certain insurance proceeds. The value of the augmented estate will be reduced by certain (i) expenses and claims; (ii) trust assets; (iii) joint interests, lifetime transfers, and property in which a decedent had a qualifying power of disposition to which the surviving spouse consented during lifetime; (iv) irrevocable transfers; and (v) life estates. Spousal benefits, held in an *inter vivos* or testamentary trust for the spouse, or that otherwise pass to the spouse at the decedent's death, also will reduce the augmented estate. However, an *inter vivos* trust created for both a spouse and descendants, such as a life insurance trust, will not be considered a spousal benefit and therefore will not reduce the augmented estate.

Process for Making Election: The election will be made by filing within the later of (i) nine months after the decedent's death or (ii) six months after the first appointment of a personal representative. The filing will be made to the court that appointed the personal representative or in the court of the jurisdiction of the decedent's residence at death. A three-month extension to file the election may be granted "for good cause shown." The surviving spouse may withdraw the election at any time before the deadline for making the election expires. While these time frames are the same as under current law, additional steps and new notices will be required. These help to ensure that the surviving spouse, the trustee of the decedent's revocable trust, the estate tax return preparer, and the personal representative have information about the estate necessary to calculate the elective share.

Effect of Changes: According to Md. Code, Est. & Trusts § 3-402, the purpose of the new law is to make reasonable provisions for a surviving spouse during his/her remaining lifetime and allow a decedent flexibility in ordering his/her affairs. Taking the share from the augmented estate also reflects (i) the increasingly common use of the revocable trust as a Will substitute; (ii) the view of marriage as an economic partnership; and (iii) the inclusion of all assets controlled by either spouse during lifetime. However, an election against the estate undoes the decedent's estate plan and may disrupt the expectancies of heirs who have to contribute part of their inheritance to the spousal share. The election may also have financial consequences, by bringing assets previously transferred by the decedent back into the estate and causing recalculation of the marital deduction.

Estate Planning Tips: While a decedent's heirs may petition a court to modify the value of the spouse's elective share or the property to which it applies, planning ahead to address potential family conflicts is preferable to judicial intervention. Premarital agreements and post-marital agreements may waive a spouse's right to take an elective share or the extent to which the election applies to certain assets. A spouse may also consent to the other spouse's transfer of specific assets to a third party. For blended families, making planning decisions for the spouse apart from other heirs, such as by establishing separate trusts and purchasing separate life insurance policies for these two sets of beneficiaries, is recommended. The new law affects many property interests through a complex system for satisfaction of a spouse's elective share. Married individuals should seek guidance from an experienced estate planning attorney to minimize unwanted consequences upon a spouse's death.

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PLANNING CONSIDERATIONS WITH RESPECT TO THE SECURE ACT

By Ken Jefferson

The Setting Every Community Up for Retirement Enhancement, or SECURE, Act became law on December 20, 2019. Intended to aid and equip all Americans with the ability to better prepare for retirement, the law has introduced several changes to the overall landscape of retirement plans and planning strategies to: (i) encourage more employers to offer retirement plan options to their employees and (ii) provide more employees with access to plans. Its provisions are generally effective beginning January 1, 2020.

The SECURE Act includes the following features: (i) providing tax credits and protections to small businesses that offer employees 401(k) plans to foster an increase in availability of options to employees to save for retirement, (ii) providing long-term, part-time employees access to retirement benefits, (iii) eliminating the retirement contribution maximum age limit of 70½, (iv) increasing the age at which required minimum distributions (RMDs) must be taken from 70½ to 72, (v) allowing withdrawals of up to $5,000 from retirement assets penalty-free for the birth or adoption of a child, and (vi) easing of the rules to which employers are subject when offering annuities through sponsored plans.

IPB Tax, Trusts & Estates Past Issues

To finance the above-referenced modifications to the old rules, the SECURE Act introduced a change that effectively eliminated the availability of the lifetime stretch Individual Retirement Account (IRA) planning strategy. A beneficiary of an inherited IRA may now only stretch out the distributions over a maximum 10-year period during which there are no longer any RMDs, and after which all of the funds must be distributed out of the account and income taxes paid (in the case of a traditional IRA), unless the beneficiary qualifies as Eligible Designated Beneficiary (EDB). Under the new rules, an EDB includes: the account owner's surviving spouse and minor children, disabled and chronically ill individuals, and individuals not more than 10 years younger than the account owner. Different rules apply to each of these.

For surviving spouses, the rules essentially have not changed. A surviving spouse may still stretch the distributions for his or her lifetime. Minor children, but not grandchildren, of the account owner may stretch distributions until they reach the age of majority, at which point they become subject to the 10-year rule. Disabled and chronically ill individuals (who are disabled or chronically ill at the time the IRA is inherited) may take distributions over their lifetimes, provided they qualify under the IRS's strict guidelines. Individuals, usually siblings, who are not more than 10 years younger than the account owner may also stretch distributions over their lifetimes.

By limiting the maximum stretch period to 10 years for most beneficiaries of inherited IRAs, the payment of income taxes is accelerated. Consequently, the use of the stretch IRA as a wealth accumulation tool to benefit other family members, some of whom may be minors, has been disrupted -- especially if trusts are part of the plan.

Generally, there are two ways to designate a trust as a beneficiary of an IRA: (i) a conduit trust or (ii) an accumulation trust. Conduit trusts force out the RMDs to the trust beneficiary, whereas accumulation trusts allow a trustee discretion to either retain or pay out the RMDs, whichever is most tax-efficient. With the new 10-year maximum stretch period, a conduit trust designated as beneficiary of a large IRA could end up distributing to the trust beneficiary a much larger sum, earlier in life than the account owner intended while also subjecting the beneficiary to a hefty tax bill at the end of the 10-year period.

Under the new rules, an accumulation trust may be preferable. While the 10-year period will still apply, a properly drafted accumulation trust will allow the trustee the discretion to make distributions on the most tax-efficient basis. Moreover, while trusts reach the highest income tax rate at income just above $13,150, and the trust will be responsible for the tax on income remaining in trust, there may be other tax and non-tax considerations to still utilize a trust structure. Another option for minimizing the tax liability of the beneficiary is for the account owner to make a Roth conversion so that distributions to the inherited IRA beneficiaries will be tax-free. Finally, a current retirement plan participant may wish to consider making new 2020 contributions into a Roth 401(k) rather than a traditional 401(k) plan, so that on his or her death, the beneficiary of the inherited account receives it tax-free.