Tax Law Update

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I. Introduction

This presentation highlights updates to tax laws and guidance issued from October 2022 to September 2023. A special thank you to LeeAnne Shocklin, Esq. for your contributions to these materials.

II. Gift and Estate Tax Exemption Changes in 2023

Established by the American Taxpayer Relief Act (ATRA) of 2012, the $5 million estate and gift tax exemption limit has been expanded and adjusted for inflation in the years since its inception. For the last five years, taxpayers have benefited from the historically high gift and estate tax exemptions introduced under the Tax Cuts and Jobs Act of 2017, which doubled the exemption for 2018 from approximately $5.5 million to $11.18 million per person adjusted for inflation.[1] It is likely that the increase for 2024 will be announced prior to the presentation and the necessary update will be made at that time.

a. 2023 Exemption Increase

i. Federal

Effective January 1, 2023, the federal gift/estate tax exemption and generation-skipping transfer (GST) tax exemption increased from $12.06 million to $12.92 million per person (an $860,000 increase).[2]

The federal annual exclusion from gift tax amount also increased in 2023 from $16,000 to $17,000 per recipient.[3]

ii. State

Twelve states (WA, OR, MN, IL, VT, NY, ME, MA, RI, CT, HI, MD) and DC impose estate taxes and six states (NE, IA, KY, PA, NJ, MD) impose inheritance taxes.[4] Maryland is the only state to impose both an estate and inheritance tax.[5]

Effective January 1, 2023, the estate tax exemption amount in Connecticut increased to $12.92 million,[6] the estate tax exemption amount in New York

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[1] https://cbh.com/guide/articles/estate-and-gift-tax-exemption-sunset-2025-how-to-prepare/#:~:text=Elevated%20Gift%20Tax%20Exclusions%20Will,indexed%20for%20inflation%20after%202018.
[2] https://www.irs.gov/businesses/small-businesses-self-employed/whats-new-estate-and-gift-tax.
[3] https://www.irs.gov/businesses/small-businesses-self-employed/whats-new-estate-and-gift-tax
[4] https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/estate-and-inheritance-taxes
[5] https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/estate-and-inheritance-taxes
[6] https://portal.ct.gov/DRS/Individuals/Individual-Income-Tax-Portal/Estate-and-Gift-Taxes/Tax-Information#:~:text=For%20estates%20of%20decedents%20dying,is%20more%20than%20%2412.92%20million.

increased to $6.58 million,[7] and the estate tax exemption amount in the District of Columbia increased to $4,528,000.[8]

b. Looming 2026 Reduction

The federal gift/estate tax exemption and GST tax exemption will continue to increase each year for inflation through December 31, 2025. However, under current law, on January 1, 2026, the exemption amounts are scheduled to return to the $5 million limit established under ATRA, indexed for inflation.[9]

III. SECURE 2.0 Act of 2022

a. Overview

On December 29, 2022, President Biden signed into law the Consolidated Appropriations Act of 2023.[10] This Act is a $1.7 trillion omnibus spending bill funding the U.S. federal government for the 2023 fiscal year.[11]

The SECURE 2.0 Act is meant to expand on the Setting Every Community Up for Retirement (SECURE) Act of 2019, which modified retirement plans, individual retirement accounts, and other tax-favored savings accounts.[12]

b. SECURE 2.0 Act Highlights

The SECURE 2.0 Act has 92 provisions aimed at increasing savings, boosting business incentives, and incentivizing those saving for retirement. While some provisions became effective upon the Act's enactment, others will go into effect over the next five years. Some of the provisions of the Act are highlighted below.

i. Required Minimum Distributions

1. <u>Section 107, Increase in age for required beginning date for mandatory distributions</u>.[13]

Under current law, participants are generally required to begin taking distributions from their retirement plans at age 72. The policy behind this rule is to ensure that individuals spend their retirement savings during their lifetime and not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries. The

[7] https://www.tax.ny.gov/pit/estate/etidx.htm#bea
[8] https://otr.cfo.dc.gov/sites/default/files/dc/sites/otr/publication/attachments/2023_D-76%20-%20Final.pdf
[9] https://www.irs.gov/newsroom/estate-and-gift-tax-faqs
[10] https://www.congress.gov/bill/117th-congress/house-bill/2617/text.
[11] https://appropriations.house.gov/sites/democrats.appropriations.house.gov/files/FY23%20Summary%20of%20Appropriations%20Provisions.pdf
[12] https://www.congress.gov/bill/116th-congress/house-bill/1994
[13] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

SECURE Act of 2019 increased the required minimum distribution age to 72. Section 107 further increases the required minimum distribution age to 73 for those who turn 72 after December 31, 2022 and who turn 73 before January 1, 2033, and increases the applicable age from 73 to 75 for those who turn 73 on or after January 1, 2033.

2. Section 201, Remove required minimum distribution barriers of life annuities.[14]

   Section 201 eliminates certain barriers to the availability of life annuities in qualified plans and IRAs that arise under current law due to an actuarial test in the required minimum distribution regulations. The test is intended to limit tax deferral by precluding commercial annuities from providing payments that start out small and increase excessively over time. In operation, however, the test commonly prohibits many important guarantees that provide only modest benefit increases under life annuities. Without these types of guarantees, the IRS believes many individuals are unwilling to elect a life annuity under a defined contribution plan or IRA. Section 201 is effective for calendar years ending after the date of enactment of this Act.

3. Section 302, Reduction in excise tax on certain accumulations in qualified retirement plans.[15]

   Section 302 reduces the penalty for failure to take required minimum distributions from 50 to 25 percent. Further, if a failure to take a required minimum distribution from an IRA is corrected in a timely manner, the excise tax on the failure is further reduced from 25 percent to 10 percent. Section 302 is effective for taxable years beginning after the date of enactment of this Act.

4. Section 313, Individual retirement plan statute of limitations for excise tax on excess contributions and certain accumulations.[16]

   Under current law, the statute of limitations for excise taxes imposed on excess contributions, or required minimum distribution failures start running as of the date that a specific excise tax return (Form 5329) is filed for the violation. Individuals often are not aware of the requirement to file Form 5329, and this can lead to an indefinite

[14] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[15] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[16] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

period of limitations that can cause hardship for taxpayers due to the accumulation of interest and penalties (see Paschall v. C.I.R., 137 T.C. 8 (2011)). In order to provide finality for taxpayers in the administration of these excise taxes, Section 313 provides that a 3-year period of limitations begins when the taxpayer files an individual tax return (Form 1040) for the year of the violation, except in the case of excess contributions, in which case the period of limitations runs 6 years from the date Form 1040 is filed. There is a further exception from this 6 year rule for taxes that arise out of a bargain sale to the IRA. Section 313 is effective on the date of enactment of this Act.

5. Section 325, Roth plan distribution rules.[17]

   Under current law, required minimum distributions are not required to begin prior to the death of the owner of a Roth IRA. However, pre-death distributions are required in the case of the owner of a Roth designated account in an employer retirement plan (e.g., 401(k) plan). Section 325 eliminates the pre-death distribution requirement for Roth accounts in employer plans, effective for taxable years beginning after December 31, 2023. Section 325 does not apply to distributions which are required with respect to years beginning before January 1, 2024, but are permitted to be paid on or after such date.

6. Section 337, Modification of required minimum distribution rules for special needs trust.[18]

   The SECURE Act placed limits on the ability of beneficiaries of defined contribution retirement plans and IRAs to receive lifetime distributions after the account owner's death. Special rules apply in the case of certain beneficiaries, such as those with a disability. Section 337 clarifies that, in the case of a special needs trust established for a beneficiary with a disability, the trust may provide for a charitable organization as the remainder beneficiary. Section 337 is effective for calendar years beginning after the date of enactment of this Act.

ii. Catch-Up Contribution Limits

[17] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[18] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

1. Section 109, Higher catch-up limit to apply at age 60, 61, 62, and 63.[19]

   Under current law, employees who have attained age 50 are permitted to make catch-up contributions under a retirement plan in excess of the otherwise applicable limits. Section 109 increases these limits to the greater of $10,000 or 50 percent more than the regular catch-up amount in 2025 for individuals who have attained ages 60, 61, 62 and 63. The increased amounts are indexed for inflation after 2025. Section 109 is effective for taxable years beginning after December 31, 2024.

2. Section 333, Elimination of additional tax on corrective distributions of excess contributions.[20]

   Current law requires a distribution if too much is contributed to an IRA. The corrective distribution includes the excessive contribution and any earnings allocable to that contribution. Section 333 exempts the excess contribution and earnings allocable to the excess contribution from the 10 percent additional tax on early distributions, and is effective for any determination of, or affecting, liability for taxes, interest, or penalties which is made on or after the date of enactment of this Act, without regard to whether the act (or failure to act) upon which the determination is based occurred before such date of enactment.

3. Section 603, Elective deferrals generally limited to regular contribution limit.[21]

   Under current law, catch-up contributions to a qualified retirement plan can be made on a pre-tax or Roth basis (if permitted by the plan sponsor). Section 603 provides all catch-up contributions to qualified retirement plans are subject to Roth tax treatment, effective for taxable years beginning after December 31, 2023. An exception is provided for employees with compensation of $145,000 or less (indexed).

iii. Miscellaneous Provisions

[19] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[20] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[21] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

1. Section 307, One-time election for qualified charitable distribution to split-interest entity; increase in qualified charitable distribution limitation.[22]

   Section 307 expands the IRA charitable distribution provision to allow for a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts, effective for distributions made in taxable years beginning after the date of enactment of this Act. Section 307 also indexes for inflation the annual IRA charitable distribution limit of $100,000, effective for distributions made in taxable years ending after the date of enactment of this Act.

2. Section 327, Surviving spouse election to be treated as employee.[23]

   Section 327 allows a surviving spouse to elect to be treated as the deceased employee for purposes of the required minimum distribution rules. Section 327 is effective for calendar years beginning after December 31, 2023.

3. Section 334, Long-term care contracts purchased with retirement plan distributions.[24]

   Section 334 permits retirement plans to distribute up to $2,500 per year for the payment of premiums for certain specified long term care insurance contracts. Distributions from plans to pay such premiums are exempt from the additional 10 percent tax on early distributions. Only a policy that provides for high quality coverage is eligible for early distribution and waiver of the 10 percent tax. Section 334 is effective 3 years after date of enactment of this Act.

4. Section 604, Optional treatment of employer matching or nonelective contributions as Roth contributions.[25]

   Under current law, plan sponsors are not permitted to provide employer matching contributions in their 401(k), 403(b), and governmental 457(b) plans on a Roth basis. Matching contributions must be on a pre-tax basis only. Section 604 allows defined contribution plans to provide participants with the option of

[22] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[23] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[24] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[25] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

receiving matching contributions on a Roth basis, effective on the date of enactment of this Act.

iv. Exemption from Early Withdraw Penalties

1. Section 314, Penalty-free withdrawal from retirement plans for individual case of domestic abuse. [26]

   A domestic abuse survivor may need to access his or her money in their retirement account for various reasons, such as escaping an unsafe situation. Section 314 allows retirement plans to permit participants that self-certify that they experienced domestic abuse to withdraw a small amount of money (the lesser of $10,000, indexed for inflation, or 50 percent of the participant's account). A distribution made under Section 314 is not subject to the 10 percent tax on early distributions. Additionally, a participant has the opportunity to repay the withdrawn money from the retirement plan over 3 years and will be refunded for income taxes on money that is repaid. Section 318 is effective for distributions made after December 31, 2023.

2. Section 126, Special rules for certain distributions from long-term qualified tuition programs to Roth IRAs.[27]

   Section 126 amends the Internal Revenue Code to allow for tax and penalty free rollovers from 529 accounts to Roth IRAs, under certain conditions. Beneficiaries of 529 college savings accounts would be permitted to rollover up to $35,000 over the course of their lifetime from any 529 account in their name to their Roth IRA. These rollovers are also subject to Roth IRA annual contribution limits, and the 529 account must have been open for more than 15 years. Families and students have concerns about leftover funds being trapped in 529 accounts unless they take a non-qualified withdrawal and assume a penalty. This has led to hesitating, delaying, or declining to fund 529s to levels needed to pay for the rising costs of education. Section 126 eliminates this concern by providing families and students with the option to avoid the penalty, resulting in families putting more into their 529 account. Families who sacrifice and save in 529 accounts should not be punished with tax and penalty years later if the beneficiary has found an alternative way to

[26] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[27] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

pay for their education. They should be able to retain their savings and begin their retirement account on a positive note. Section 126 is effective with respect to distributions after December 31, 2023.

3. Section 326, Exception to penalty on early distributions from qualified plans for individuals with a terminal illness.[28]

   Under current law, an additional 10 percent tax applies to early distributions from tax-preferred retirement accounts. Section 326 provides an exception to the tax in the case of a distribution to a terminally ill individual and would be effective for distributions made after the date of enactment of this Act.

4. Section 329, Modification of eligible age for exemption from early withdrawal penalty.[29]

   The 10 percent additional tax on early distributions from tax preferred retirement savings plans does not apply to a distribution from a governmental plan to a public safety officer who is at least age 50. Section 329 extends the exception to public safety officers with at least 25 years of service with the employer sponsoring the plan and is effective for distributions made after the date of enactment of this Act.

5. Section 330, Exemption from early withdrawal penalty for certain State and local government corrections employees.[30]

   Section 330 extends the public safety officer exception to the 10 percent early distribution tax to corrections officers who are employees of state and local governments, effective for distributions made after the date of enactment of this Act.

6. Section 602, Hardship withdrawal rules for 403(b) plans.[31]

   Under current law, the distribution rules for 401(k) and 403(b) are different in certain ways that are historical anomalies for varied reasons. For example, for 401(k) plans, all amounts are available for a hardship distribution. For 403(b) plans, in some cases, only employee contributions (without earnings) are available for hardship distributions. Section 602 conforms the 403(b) rules to the

[28] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[29] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[30] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf
[31] https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf

401(k) rules, effective for plan years beginning after December 31, 2023.

IV. 2023 Revenue Rulings, Revenue Procedures, and Notices

A "revenue ruling" is an official interpretation by the IRS of the Internal Revenue Code, related statutes, tax treaties, and/or regulations. It is the IRS' conclusion about how the law is applied to a specific set of facts.[32]

A "revenue procedure" is an official statement of a procedure under the Internal Revenue Code, related statutes, tax treaties and/or regulations that affects the rights or duties of taxpayers and should be a matter of public knowledge.[33]

A "notice" is a public announcement that may contain guidance involving substantive interpretations of the Internal Revenue Code.[34]

The following is a summary of important revenue rulings, revenue procedures, and notices issued by the IRS in 2023. Not all revenue rulings, revenue procedures, and notices issued in 2023 are addressed in these materials.[35]

a. Revenue Ruling 2023-2

Rev. Rul. 2023-2 provides guidance on application of the basis adjustment under Section 1014 to assets of an irrevocable grantor trust not included in a deceased grantor's gross estate.

i. 26 U.S.C. § 1014

Section 1014(a) generally provides that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent, if not sold, exchanged, or otherwise disposed of before the decedent's death by that person, is the fair market value of the property at the date of the decedent's death.[36]

Section 1014(b) lists seven types of property that are considered to have been acquired from or to have passed from the decedent for the purposes of Section 1014(a): (1) property acquired by bequest, devise or inheritance, or by the decedent's estate from the decedent; (2) property where a decedent had, while alive, the power to (a) revoke or (b) amend the trust or hold a power to appoint the assets; (3) property transferred under a testamentary

[32] https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer
[33] https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer
[34] https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer
[35] For a summary of all IRS guidance issued in 2023, please visit: https://www.sjsu.edu/people/annette.nellen/website/2023_IRS_IRB_Rulings.pdf.
[36] 26 U.S.C. § 1014(a)(1).

general power of appointment; (4) community property; (5) property that is included in a decedent's gross estate under the provisions of Chapter 11; and (6) property included in a surviving spouse's estate due to a marital deduction allowed in the first-to-die spouse's estate.

ii. The Loophole

Section 1014 typically permits taxpayers receiving certain property from a decedent to increase the basis of such property to fair market value at the time of death. Importantly, what would not be included in the language of section 1014(b) are assets outside of the estate, such as those held in an irrevocable trust.

However, the termination of an irrevocable trust at the death of the grantor is often treated as a "bequest" or "devise" under Section 1014. As such, this inheritance would be eligible for the stepped-up basis treatment thus reducing the amount of capital gains taxes owed and shielding the inheritance from taxes.

iii. Impact

Until recently, the IRS was silent as to whether the phrase "bequest, devise, or inheritance" in Section 1014(b)(1) applies to the termination of grantor trust status upon the grantor's death or to the transfer of an irrevocable grantor trust's property upon a grantor's death. However, on March 29, 2023, the IRS issued Revenue Rule 2023-2 which addresses this unsettled issue.

The IRS concluded that the basis adjustment under Section 1014 generally does not apply to the assets of an irrevocable grantor trust not included in the deceased grantor's gross estate for federal tax purposes.[37] Trust assets are not "bequeathed," "devised," or "inherited" within the meaning of Section 1014(b)(1) to justify a step-up pursuant to Section 1014(a).[38] As such, the assets in the trust at the grantor's death would maintain the same basis as that immediately prior to the grantor's death.

b. Revenue Ruling 2023-8

Rev. Rul. 2023-8 revoked a prior revenue ruling and terminated a taxpayer's ability to correct missed deductions for research and experimental expenses effective July 31, 2023.[39]

[37] https://www.irs.gov/pub/irs-drop/rr-23-02.pdf
[38] https://www.irs.gov/pub/irs-drop/rr-23-02.pdf
[39] https://www.irs.gov/pub/irs-drop/rr-23-08.pdf

i. Revocation of Rev. Rul. 58-74

Prior to amendment by Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA), Section 174(a) permitted a taxpayer to currently deduct research or experimental expenditures that were paid or incurred during the taxable year in connection with its trade or business (the "expense method"). If the expense method was adopted, it had to be used for all qualifying expenditures in the tax year adopted and for all subsequent years, unless the IRS Commissioner consented to a different method for all or part of the expenditures under former Section 174(a)(3).

Rev. Rul. 58-74 provides that if a taxpayer adopted the expense method but failed to deduct expenses relating to the cost of obtaining a patent or other items of research and experimental expenditures for prior taxable years to which the expense method is applicable, the taxpayer should file a claim for refund or amended return to deduct additional research and experimental expenditures in the year or years when the expenditures were paid or accrued. Rev. Rul. 58-74 further provides that the additional research and experimental expenditures cannot be treated as deferred and amortized under former Section 174(b) or chargeable to capital account and subsequently amortized or written off upon abandonment of the project or projects because the Commissioner's consent to change a method of accounting was not obtained. Accordingly, the deduction for the additional research and experimental expenditures could be lost if the period of limitations on claims for credit or refund has expired and amended returns could not be timely filed.

The TCJA amended Section 174 to provide that research and experimental expenditures for costs incurred in tax years beginning after December 31, 2021, must be charged to a capital account and amortized ratably over 5 years if the research is performed in the United States (or over 15 years for expenditures attributable to foreign research).

ii. Impact

The Treasury Department and the IRS are obsoleting Rev. Rul. 58-74 not because of the change in law under Section 174, but because there are insufficient facts in the ruling to properly analyze whether the taxpayer's failure to deduct certain research and experimental expenditures constituted a method of accounting or an error.

Rev. Rul. 58-74 is obsoleted effective July 31, 2023. As such, taxpayers may file a claim for refund, amended return, or Administrative Adjustment Request (AAR), as applicable, in reliance on Rev. Rul. 58-74 if the taxpayer is (1) claiming a deduction for additional research or experimental expenditures to which the expense method under former Section 174(a) is

applicable for the taxable year or years in which they were improperly deferred or capitalized, (2) otherwise using the expense method for such taxable year or years, and (3) timely filing the claim for refund, amended return, or AAR not later than July 31, 2023.[40]

c. Revenue Ruling 2023-14

Rev. Rul. 2023-14 addresses cryptocurrency and when cryptocurrency rewards are included in income.[41]

i. Ruling

A taxpayer using the cash-method of accounting must include in gross income the fair market value of rewards received through cryptocurrency staking in the year the taxpayer gains dominion and control over the rewards.[42]

1. <u>What is cryptocurrency staking?</u>

   Crypto staking is a way of earning rewards for holding certain cryptocurrencies, specifically those that utilize a proof-of-stake model (for example, Ethereum).[43] By holding and staking the cryptocurrency for a period, a holder assists in verifying and securing the blockchain.[44]

   Holders earn passive income by helping to secure the network and validate transactions. If a validator is chosen by the protocol for the blockchain, and validation is successful, the validator will receive a reward, such as additional units of the cryptocurrency.[45]

2. <u>Dominion and Control</u>

   "Dominion and control" over the rewards occurs once the taxpayer is able to sell, exchange, or otherwise dispose of any interest in the reward from serving as a successful validator.[46]

3. <u>Internal Revenue Code Section 83</u>

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[40] https://www.irs.gov/pub/irs-drop/rr-23-08.pdf
[41] https://www.irs.gov/pub/irs-drop/rr-23-14.pdf
[42] https://www.irs.gov/pub/irs-drop/rr-23-14.pdf
[43] The main alternative to the proof-of-stake model is the proof-of work model. Bitcoin utilizes the proof-of-work model, which relies on Bitcoin mining rather than staking.
[44] https://www.reuters.com/business/finance/what-is-staking-cryptocurrency-practice-regulators-crosshairs-2023-02-10/
[45] https://www.irs.gov/pub/irs-drop/rr-23-14.pdf
[46] https://www.irs.gov/pub/irs-drop/rr-23-14.pdf

Rev. Rul. 2023-14 specifically states that its does not address any issues that may arise under any rules not specifically cited, such as section 83.[47]

Under section 83(a), if property is transferred to another person in connection with the performance of services, that property is generally valued and included in income by the service provider "at the first time the rights of the person having beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier."[48]

Rev. Rul. 2023-14 does not explain why the "dominion and control" test rather than the test utilized under section 83 is used.

ii. Impact

The IRS ruling seems to reject the position advanced by some that a newly minted cryptocurrency token is self-created property that is not taxable until the taxpayer disposes of the property in a taxable transaction. [49]

In *Jarrett, et al. v. United States*[50], plaintiff taxpayer sued the IRS for a refund of his 2019 taxes. He argued that because he only owed taxes on the cryptocurrency tokens he created through staking when he sold or transferred the tokens, he had not realized the income on the tokens, and, therefore, had overpaid his taxes and was entitled to a refund. The IRS argued the contrary (a position later repeated in Rev. Rul. 2023-14), that the rewards produced through staking increase the taxpayer's gross income at the time of receipt and, therefore, a taxpayer owes tax on the income for the year in which the rewards are received. Interestingly, however, prior to trial in the district court, the Attorney General issued Plaintiff his full refund request and directed the IRS to schedule an overpayment. As a result, the district court dismissed the case as moot. The Court of Appeals for the Sixth Circuit affirmed.

Why the IRS decided to sidestep the courts and instead issue a guideline is unclear. However, Rev. Rul. 2023-14 establishes precedent that rewards earned through staking must be reported as income for the year in which the taxpayer has dominion and control over the reward.

d. **Revenue Procedure 2023-3**

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[47] https://www.irs.gov/pub/irs-drop/rr-23-14.pdf
[48] https://www.govinfo.gov/content/pkg/USCODE-2021-title26/pdf/USCODE-2021-title26-subtitleA-chap1-subchapB-partII-sec83.pdf
[49] See 26 U.S.C. § 61(a)
[50] Jarrett, et al. v. United States, No. 22-6023 (6th Cir. 2023).

i. Purpose

When appropriate, the IRS will answer taxpayer inquiries regarding their status for tax purposes and the tax effects of their transactions, prior to the filing of returns or reports required by revenue laws.

Rev. Proc. 2023-3[51] provides a revised list of those areas of the Internal Revenue Code relating to issues on which the IRS will not issue, will not ordinarily issue, or will temporarily not be issuing letter rulings or determination letters.

ii. Highlights

Section 5.02 states that the IRS will temporarily not issue rulings on any issue involving the application of the Inflation Reduction Act of 2022 as such area is under study.

e. **Revenue Procedure 2023-5**

i. Purpose

Rev. Pro. 2023-5[52] explains the procedures for issuing determination letters on tax-exempt status, private foundation status, and other determinations related to tax-exempt organizations. These procedures also apply to revocation or modification of determination letters. This revenue procedure also provides guidance on the exhaustion of administrative remedies for purposes of declaratory judgment under § 7428. Finally, this revenue procedure provides guidance on applicable user fees for requesting determination letters.

ii. Highlights

Revisions reflect mandatory e-filing of Form 1024 (Application for Recognition of Exemption Under section 501(a) or section 521 of the Internal Revenue Code)

A clarification in section 9.02 that an organization may protest/appeal a proposed adverse determination letter on the classification or reclassification of a section 4947(a)(1) non-exempt charitable trust as described in section 509(a)(3).

Rev. Proc. 2023-5, section 13.02 has been updated to note that favorable determination letters issued in 2014 and later are available on Tax Exempt Organization Search.

[51] https://www.irs.gov/pub/irs-irbs/irb23-01.pdf
[52] https://www.irs.gov/pub/irs-irbs/irb23-01.pdf

f. Notice 2023-54

Notice 2023-54[53] provides transition relief for plan administrators, payors, plan participants, IRA owners, and beneficiaries in connection with the change in the required beginning date for required minimum distributions (RMDs) under § 401(a)(9) of the Internal Revenue Code pursuant to § 107 of the SECURE 2.0 Act of 2022.

i. SECURE 2.0 Act Impact

Following enactment of the SECURE 2.0 Act, plan administrators and other payors indicated that automated payment systems would need to be updated to reflect the change in the required beginning date under § 401(a)(9)(C) pursuant to § 107 of the SECURE 2.0 Act. They expressed concern that these revisions could take some time to implement and, as a result, plan participants and IRA owners who would have been required to begin receiving RMDs for calendar year 2023 but for § 107 of the SECURE 2.0 Act (i.e., those who will attain age 72 in 2023) and who receive distributions in 2023 could have had those distributions mischaracterized as RMDs (and therefore ineligible for rollover).

See section III above for additional information regarding the SECURE 2.0 Act.

ii. Guidance Regarding Change in Beginning Date Under SECURE 2.0 Act

A payor or plan administrator will not be considered to have failed to satisfy the requirements of §§ 401(a)(31), 402(f), and 3405(c) merely because of a failure to treat certain distributions as eligible rollover distributions. This relief applies with respect to any distribution made from a plan between January 1, 2023, and July 31, 2023, to a participant born in 1951 (or that participant's surviving spouse) that would have been an RMD but for the change in the required beginning date under § 107 of the SECURE 2.0 Act.

The Treasury Department and the IRS are extending the 60-day rollover period for any impacted distribution (as described in section *i* above) so that the deadline for rolling over such a distribution will be September 30, 2023. The Treasury Department and the IRS also are extending the 60-day rollover period for certain IRA distributions made to an IRA owner (or the IRA owner's surviving spouse), so that the deadline for rolling over that portion of the distribution will be September 30, 2023. The distributions that are subject to this extension are distributions made from an IRA between January 1, 2023, and July 31, 2023, to an IRA owner born in 1951 (or that

[53] https://www.irs.gov/pub/irs-drop/n-23-54.pdf

individual's surviving spouse) that would have been RMDs but for the change in the required beginning date under § 107 of the SECURE 2.0 Act.

iii. Guidance for Specified RMDs

1. Definition of Specified RMD

For purposes of Notice 2023-54, a "Specified RMD" is any distribution that, under the interpretation included in the proposed regulations, would be required to be made pursuant to § 401(a)(9) in 2023 under a defined contribution plan or IRA that is subject to the rules of § 401(a)(9)(H) for the year in which the employee (or designated beneficiary) died if that payment would be required to be made to:

- A designated beneficiary of an employee under the plan (or IRA owner) if: (1) the employee (or IRA owner) died in 2020, 2021, or 2022, and on or after the employee's (or IRA owner's) required beginning date, and (2) the designated beneficiary is not using the lifetime or life expectancy payments exception under § 401(a)(9)(B)(iii); or
- A beneficiary of an eligible designated beneficiary (including a designated beneficiary who is treated as an eligible designated beneficiary pursuant to § 401(b)(5) of the SECURE Act) if: (1) the eligible designated beneficiary died in 2020, 2021, or 2022, and (2) that eligible designated beneficiary was using the lifetime or life expectancy payments exception under § 401(a)(9)(B)(iii) of the Code.

2. Failure to Make or Specified RMD

A defined contribution plan that failed to make a Specified RMD will not be treated as having failed to satisfy § 401(a)(9) merely because it did not make that distribution.

To the extent a taxpayer did not take a Specified RMD, the IRS will not assert that an excise tax is due under § 4974.

V. Important Caselaw Developments

a. Estate of Cecil v. Commissioner (T.C. Memo. 2023-24)

i. Summary: In 2010, Mr. William A.V. Cecil, Sr. (grandson of George Vanderbilt and whose mother inherited the faced Vanderbilt Biltmore House

in Ashville, North Carolina) and his Wife gave stock in an S Corporation that owned the Biltmore House and some surrounding land and tourist facilities ("TBC") to their children and grandchildren. The donors attached an appraisal to the gift tax return; however, the IRS calculated the value of the gifts to be substantially more and asserted a gift tax deficiency of $13.1 million by each donor. Mr. and Mrs. Cecil challenged the IRS's deficiency action. A trial, the parties called experts to testify in support of each party's proposed stock value. While the court did not come to a value of the gifted shares, it accepted the valuation reached by Petitioners' expert with some adjustments. Despite past rejection of using tax-affecting to determine an S corporation's fair market value, the court applied tax affecting "given the unique setting at hand" and declined to find that tax-affecting is "always, or even more than not, a proper consideration for valuing an S corporation." With the discounts and use of tax-affecting, the resulting valuation will result in a significant refund to the taxpayers from the amounts reported on their gift tax returns.

ii. *Takeaway*: Tax-affecting refers to the step in the valuation of closely-held businesses that seeks to adjust for certain differences between passthrough entities and C corporations. the IRS has generally taken the position that an entity-level tax should not be applied in determining the projected earnings and value of an S corporation While the court applied tax-affecting in this case, it emphasized that it was appropriate "given the unique setting at hand." The lack of clarity creates uncertainty for taxpayers.

b. Connelly v. United States, No. 21-3683 (8th Cir. June 2, 2023)

i. *Summary*: Two brothers were the sole shareholders of a corporation. The corporation's buy-sell agreement required that the corporation purchase the shares of a decedent shareholder. The pricing provision of the agreement required the brothers to mutually agree as to the value each year. If they could not agree on the annual value, then the price would be determined by securing two more appraisals. The brothers never complied with the terms of the pricing provision. The company funded the agreement with a $3.5 million life insurance policy on each of the brothers' lives, so that if one of the shareholders died, the corporation could use the proceeds to redeem that shareholder's shares.

One of the shareholders subsequently died, and the IRS assessed taxes on his estate, which included his stock interest in the corporation. While the estate reported the shares at approximately $3.1 million, the IRS took the position that the fair market value of the corporation included the life insurance proceeds intended for the stock redemption. As a result, the IRS

sent a notice of deficiency to the estate for $1 million in additional tax liability. The estate paid the deficiency and sued for a refund.

The district court determined that the buy-sell agreement did not fix the value of the shares and granted summary judgment to the IRS. The taxpayer appealed to the 8th Circuit Court of Appeals. The 8th Circuit affirmed the lower court's decision, concluding (1) that the stock-purchase agreement requiring the redemption of a deceased shareholder's shares did not affect the value of the shares for estate tax purposes under section 2703(b) because the agreement did not provide for a "fixed and determined price" in light of the fact that the parties "ignored the agreement's pricing mechanisms", and (2) that a proper valuation of the corporation in accordance with sections 2042 and 2031 must include the life insurance proceeds without treating the obligation to redeem shares as an offsetting liability. In doing so, the Circuit court declined to follow setting up a potential split in the Circuits.

ii. *Takeaway*: The 8th Circuit declined to follow *Estate of Blount v. Commissioner,* 428 F.3d 1338 (11th Cir. 2005). In *Estate of Blout*, the court viewed the life insurance proceeds as an asset directly offset by the liability to redeem the shares; thus, there is no effect on the company's value. As such, a split in circuits is developing.