DECEMBER UPDATE FOR ACCOUNTANTS & FINANCIAL PLANNERS

December 12, 2023

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Top 40 Federal Tax Developments of 2023 through December 7, 2023

Including those most interesting or humorous

I. Individuals

Proposed Regulations under Code Section 6011 would cause Monetized Installment Sale Transactions to be considered as Listed Transactions which must be disclosed; monetized transactions are installment sales involving an intermediary where the seller receives substantially all of the purchase price up front through a combination of downpayment and a loan.

In Hailstone v. Commissioner, TC Summary Opinion 2023-17, the Tax Court concluded that disability income was taxable to an individual whose premiums were employer-paid in pretax dollars, unsuccessfully arguing that he was not given a choice at the time and should get an exclusion.

In Roman v. Commissioner, TC Memo 2023-142, the Tax Court concluded that $700,000 paid by a landlord to a formerly married couple still living together for vacating their shared apartment was not paid for physical injury despite the poor medical condition of the former husband and that each should be taxed on $350,000 despite the former wife by agreement receiving the entire amount; the Court found that the former wife was not subject to further tax on the added $350,000 that was waived by her former husband, the IRS arguing unsuccessfully that the payment was for her being a caregiver to him after termination of the marriage but she, in fact, was being paid separately by California for providing care.

In Bibeau v. Commissioner, TC Memo 2023-66, the Tax Court conceded that treaties with Native American nations are to be interpreted based on the understanding of tribal members; however, the Court refused to expand prior interpretation of an 1837 treaty which gave the Chippewa the right to "hunt, fish and gather the wild rice" on their lands.

In Saccato v. Commissioner, TC Memo 2023-96, the Tax Court required an individual to report net rental income as well as gain from the sale of real property despite his arguments that he was not subject to federal income tax as a citizen of the state of Oregon, while also rejecting his claim that the income was reportable by a trust; he could not produce a trust document and was unable to explain at trial who were the trustees and beneficiaries.

In Gomas v. United States, 132 AFTR2d 2023-5165, a Florida Federal District Court determined that the victim of a scam in which she withdrew funds from retirement plans in a fraudulent scheme in which her daughter participated still had to report the stolen monies as income inasmuch as she did the withdrawal personally; the Court noted without analysis that a theft deduction was not available for 2019 as the result of the abolition of personal theft losses in the 2017 legislation (the argument to the contrary that retirement plans are in an investment account apparently was not made).

In Bass v. Commissioner, TC Memo 2023-41, the Tax Court denied a charitable deduction for clothing by an individual who claimed he made 173 separate trips to Goodwill and the Salvation Army and received a donation acknowledgement receipt for each trip; however, inasmuch as aggregated donations exceeded $5,000, he failed to meet the appraisal requirements for the clothing donations.

In Gregory v. Commissioner, 131 AFTR2d 2023-1864, the Eleventh Circuit Court of Appeals agreed with the Tax Court that expenses related to hobby losses can only be claimed as miscellaneous itemized deductions pre-2018 and post-2025; In Schmerling v. Commissioner, TC Summary Opinion 2023-14, the Tax Court decided that performance bonuses and commissions of a car salesman placed on a 1099 rather than a W-2 that were tied to the wage income are reportable as "other income" on the tax return and not on a Schedule C (accordingly, the associated expenses can only be claimed as miscellaneous itemized deductions pre-2018 or post-2025).

In Ledbetter v. Commissioner, TC Summary Opinion 2023-19, the Tax Court denied an expense deduction pre-2018 to a sheet metal worker whose daily round trip was 184 miles as his employment was not "temporary" in nature, the Court tacking on time with five separate contractors during his time at a single location.

In Uchizono v. Commissioner, TC Summary Opinion 2023-21, the Tax Court ruled that the type of courses taken pre-2018 by a part-time MBA student qualified her for her next job and were not deductible; the Court held that “if the education in question qualifies a taxpayer to perform tasks and activities significantly different from those he or she performed before the program, then it qualifies the taxpayer for a new trade or business.”

II. Retirement & Estate Planning

In Jadhav v. Commissioner, TC Memo 2023-140, the Tax Court concluded that two sons of a couple owning a business were employees in a year in which they received no W-2s for their research work, the W-2s commencing in the succeeding year, and permitted retirement plan contributions for the sons to be deducted, the Court noting that IRS apparently missed the fact that contributions are tied to paid compensation.

In In Re: Myatt, 132 AFTR2d 2023-________, a North Carolina bankruptcy court concluded that rights to a distribution from an ex-spouse's qualified retirement plan were protected in bankruptcy despite that a QDRO had not yet been issued, the court finding that the intended transferee had a vested ownership interest in the distribution notwithstanding.

In In Re: Green, 132 AFTR2d 2023-5728, an Illinois Federal District Court affirmed the bankruptcy court and concluded that foreign plans cannot be tax qualified retirement plans under the Bankruptcy Code and are within reach of the Trustee in bankruptcy.

In In Re: Kelly, 131 AFTR2d 2023-__________, an Iowa Federal District Court ruled that a bankrupt's IRA rolled over from the IRA of her late husband, cannot be reached by the trustee in bankruptcy in contrast to an "inherited IRA" which cannot be the subject of a rollover.

In Balint v. Commissioner, TC Memo 2023-118, the Tax Court concluded that an incarcerated taxpayer was not taxable on withdrawals from an IRA as well as a life insurance policy when the divorcing wife used a power of attorney for her own benefit and not that of her husband; the decision was based upon Florida law which did not provide the wife with "open-ended authority."

In Estate of Spizziri v. Commissioner, TC Memo 2023-25, the Tax Court determined that a wealthy attorney's payments over five years to seven women, in addition to his daughter and step daughter, were gifts inasmuch as no W-2 or 1099 was issued.

In Estate of Cecil v. Commissioner, TC Memo 2023-24, the Tax Court adopted portions of three valuation reports (two for the taxpayer and one for the IRS) in the case of a gift of minority stock in the entity owning the Biltmore property in North Carolina and (1) on the facts permitted tax effecting an S corporation; (2) rejected use of a higher valuation using the asset approach when the shares in the aggregate could not force sale of the assets and disposition was unlikely and (3) permitted a 20 percent discount for lack of control and a 19-27 percent discount for lack of marketability.

III. Business

Proposed Regulations under Code Section 170 would create reporting requirements for partners and S corporation shareholders who receive a distributive share of any noncash charitable contributions made by the entity; deductions would be denied if they exceed two and a half times the outside basis of a partner or S corporation shareholder.

In Sinopoli v. Commissioner, TC Memo 2023-105, the Tax Court disallowed most of the huge rental expenses paid to physician owners for use of their home as meeting space where the owners attempted to exclude the underlying income based on renting their homes for no more than fourteen days per year.

In Conrad v. Commissioner, TC Memo 2023-100, an S corporation was permitted to deduct expenses for both a yacht and an airplane as the majority owner was able to prove that both were extensively used or intended to be used in marketing; however, depreciation deductions on the airplane were disallowed when the owner could not get a pilot license and the plane was sent to storage.

In Clary Hood, Inc. v. Commissioner, 131 AFTR2d 2023-1875, the Fourth Circuit Court of Appeals, dropping the proposed penalty, after examining multiple factors as to reasonableness including, most importantly, comparable companies allowed about one-half of two $5 million bonuses above a $169,000 salary paid in successive years by a $70 million C corporation.

In Connelly v. United States, 131 AFTR2d 2023-1902, the Eighth Circuit Court of Appeals agreed with a Missouri Federal District Court that the buyout price set forth in a post-death agreement was not controlling as to value inasmuch as the decedent was free to dispose of the stock at any price during his lifetime and was not a formula-based price; the Court also agreed that the insurance proceeds were part of the fair market value of the corporation, an issue on which the courts are divided.

In Soroban Capital Partners LP v. Commissioner, 161 TC No. 12, the Tax Court interpreted the statutory exception to imposing self-employment tax on a partner which language excludes from SE tax "the distributive share of any item of income or loss of a limited partner, as such"; the Court found the term "as such" to require analysis beyond the nomenclature and to look at the role performed by the individual (in this case three partners received significant guaranteed payments for services on which self-employment tax was reported but the SE tax was not applied to their flow-through income).

In Cashaw v. Commissioner, 131 AFTR2d 2023-1882, the Fourth Circuit Court of Appeals affirmed a Tax Court decision holding a temporary chief administrator of a hospital personally liable for unpaid payroll taxes when she admittedly utilized funds first for "essential patient care services."

In News Release 2023-169, IRS announced a suspension on processing Employee Retention Credit claims through at least December 31, 2023 to focus on detailed compliance reviews of the large numbers of unprocessed claims as a result of aggressive and often inaccurate marketing.

In Action on Decision 2023-2, IRS announced its nonacquiescence in Complex Media v. Commissioner, at TC Memo 2021-14, which had held that a party to a transaction may not be bound by the form of a transaction and can assert substance.

IV. Procedure

Proposed Regulations under Code Section 6045, if finalized, would require crypto brokers to report gross proceeds on the sale of digital assets effective for 2025 transactions with basis information required one year later.

Proposed Regulations by FinCen, would extend the time period for newly formed companies in 2024 to report beneficial ownership information to 90 days after formation instead of 30 days; existing companies as of the start of 2024 will have one year to file their initial disclosure reports.

In Lee v. United States, 132 AFTR2d 2023-6257, the Eleventh Circuit Court of Appeals agreed with a Florida Federal District Court that the US Supreme Court's 1985 decision in Boyle, making a taxpayer responsible for late filed returns even when the accountant erred in nonfiling, also applies to electronically filed returns.

In Rosselli v. Commissioner, in a Bench Opinion, the Tax Court acquiesced in late filing and late payment penalties where the taxpayer stated he was relying on losses from a Schedule K-1 not received (because the company was raided by the FBI and found to be a Ponzi scheme).

In Tracy v. Commissioner, TC Summary Opinion 2023-20, the Tax Court abated failure to file and failure to pay penalties of a 92 year old solo practitioner attorney who was closing his practice and failed to supervise his assistant.

In Bittner v. United States, 131 AFTR2d 2023-799, the US Supreme Court by a 5-4 margin reversed the Fifth Circuit Court of Appeals and concluded that the $10,000 penalty for nonwillful failure to file the FBAR report was measured per annual filing and not per bank account; the courts have been deeply divided.

In United States v. Schwarzbaum, 131 AFTR2d 2023-1962, a Florida Federal District Court refused to stay an earlier order requiring a taxpayer to repatriate foreign assets to satisfy a judgment for taxes, penalties and interest in excess of $12.5 million; in United States v. Kelly, 132 AFTR2d 2023-6246, a Michigan Federal District Court ordered an anesthesiologist to repatriate foreign assets to pay FBAR penalties because he had insufficient assets in the US to pay the liability.

In Nutt v. Commissioner, 160 TC No. 10, the Tax Court once again threw out a petition because it was electronically filed minutes after the 11:59 p.m. eastern deadline on the 90th day (the time is based on the situs of the Tax Court in the eastern time zone and not based on the residence of the taxpayers which was in the central time zone); in Sanders v. Commissioner, 160 TC No. 16, the Tax Court threw out a Petition that was filed electronically 11 seconds after midnight Eastern Time for lack of jurisdiction.

In Culp v. Commissioner, 132 AFTR2d 2023-5198, the Third Circuit Court of Appeals reversed the Tax Court and determined that the 90-day period for filing a Petition in a deficiency is not jurisdictional and is subject to tolling, meaning good cause exceptions (the decision is only binding on the Tax Court in Pennsylvania, New Jersey and Delaware unless the Tax Court reverses itself); in Hallmark Research Collective v. Commissioner, 159 TC No. 6, a unanimous Tax Court found that the 90-day rule is absolute and not subject to equitable tolling.

In Boykin v. United States, 131 AFTR2d 2023-1718, a North Carolina Federal District Court determined that an emergency room physician who owed IRS almost $4.5 million fraudulently transferred to his new wife upon marriage a 50 percent interest in his management company plus cash for building a house; he justified the transfer based on his first wife having gotten a 50 percent of assets upon divorce.

In Organic Cannabis Foundation LLC v. Commissioner, 161 TC No. 4, a divided Tax Court concluded that IRS Appeals has the authority to grant a Collection Due Process hearing request after the 30-day deadline where good cause existed for not filing in time.

In News Release 2023-133, IRS announced that it will end most surprise visits to taxpayers by Revenue (Collection) Officers for safety purposes; the policy change does not extend to the Criminal Investigation Division.

In Information Release 2023-178, IRS announced that it will be using chatbot technology to respond to basic taxpayer questions about CP2000 and similar notices relating to matching information returns to Form 1040.

The IRS Communications and Liaison Office indicated that it is teaming with fortune cookie companies to put tax advice including deadlines inside the cookies.

The End

Planning for a Reduced Unified Credit

Overview of Current Law

Current Estate & Gift Tax Laws

- Basic exclusion amount ("BCA"), doubled from $5 million to $10 million per individual with the passage of TCJA (adjusted for inflation annually)
- $12,920,000 per person in 2023
- Will increase to $13,610,000 in 2024
- With portability, it is double for married couples ("deceased spousal unused exclusion" or "DSUE")
- TCJA higher exemptions are scheduled to sunset on 12/31/2025

Possible Strategies & Considerations

- Potential "use it or lose it" opportunity for higher exemptions – *see* anti-clawback Treasury regulations (and 2022 proposed regulations)
- Strategies include gifting to family and friends, charitable gifting, use of trusts, family business succession planning, and other means to utilize the exemption while it is still available
- This presentation will highlight a few but is not exhaustive by any means

Non-Charitable Planning Techniques

Annual Exclusion Gifts

- Perhaps the easiest way to reduce the client's estate tax liability is to make annual exclusion gifts
  - Each year an individual is allowed to make gifts valued up to $17,000 (in 2023) to as many individuals as the client wants without having to file a gift tax return
  - However, a married couple, can "split" a gift and collectively give one person $34,000
  - Assets in excess must be applied to gift/estate tax exemption. No tax paid which confuses clients

Annual Exclusion Gifts

For Instance:

A married couple can gift $34,000 each year to each grandchild

Achieving eventual tax savings because the transferred amount, and any appreciation on that amount, will not be included in their taxable estate at death

If the $34,000 was not gifted and a surviving spouse dies in 2023, the $34,000 will be taxed at 40% by the federal government (Note that the combined effective Federal and Maryland Estate Tax rate can be as high as 49.6%)

Thus, by gifting it to a grandchild, they will have achieved significant tax savings. The annual exclusion is particularly beneficial when used to provide for grandchildren because that amount will not be subject to GST Tax

Section 529 Plans

- An effective tool to use in conjunction with the annual exclusion is a 529 Plan
- A 529 Plan is a state-sponsored program that allows individuals to contribute to an account created for the purpose of paying the higher education expenses (including tuition, fees, books, supplies, and room and board) for the designated beneficiary (e.g., a grandchild)

Section 529

- A 529 Plan can provide the transferor or the beneficiary with multiple ways to save on taxes.
  - Contributions to a 529 Plan will be tax-free if it does not exceed the amount of the annual exclusion
    - One can actually contribute five (5) years’ worth of annual exclusions at once for that particular beneficiary by electing to treat the contribution as having been made ratably over five years
      - Each donor to a plan could contribute up to $85,000 to a 529 Plan in 2023 for the educational benefit of a grandchild and not pay gift tax or GST tax.

Section 529

- Contributions to a 529 Plan are deductible for state income tax purposes in many states
- The amount of the contributions and any subsequent growth will likely not be included in the taxable estate of the transferor
- Any interest earned on the contributed amount is tax-free
- Any distributions made from a 529 Plan to the beneficiary (as long as it is for higher educational purposes) are tax-free

Paying Education & Medical Expenses

- Unlike the other gifting techniques mentioned, one can also pay the educational (i.e., tuition) and/or medical expenses of a child or grandchild (or anyone else for that matter) without using up any portion of that person's annual $17,000 gift tax exclusion or $12.92 million gift tax exemption
- If the payment is made directly to the service provider (the school, doctor or hospital), it is not treated as a gift
- Accordingly, the client can make the $17,000 (or $34,000 jointly) annual exclusion gifts to a grandchild and pay his/her education and medical expenses directly without using up any of the clients' estate and gift tax exemptions

Irrevocable Life Insurance Trust ("ILIT")

- While the ownership of life insurance on one's own life or the retention of benefits (termed incidents of ownership) in the policy even if not owned will not be included generally in one's Probate Estate, the proceeds are subject to estate tax, even though the client receives no personal benefit from the policy and proceeds are payable to another party
- In contrast, if the Trustee of a properly structured ILIT obtains new life insurance on the client's life, the proceeds will not be subject to estate tax

ILITs

- If the client transfers a current policy(ies) to an ILIT, the proceeds will not be included in such individual's taxable estate as long as the transfer occurs more than three years before his/her death. Consider a sale of the policy to avoid this result
- The estate tax savings could be used to not only provide liquidity to the estate but also to provide income for the desired beneficiaries
- Using a last-to-die policy on the lives of both spouses in an ILIT can be an even more powerful tool although the downside is that neither spouse has access to the policy

ILITs

- One variation on the ILIT is to create an irrevocable trust in which the spouse is the primary beneficiary and may even be the sole trustee
  - The children and grandchildren may also be potential beneficiaries during the spouse's lifetime
  - Note most states have now waived the old common law rule against perpetuities so that the term of the trust can last many generations. Often referred to as a Perpetual or Dynasty Trust

ILITs

- While a common concern is that the insured has lost the benefits of the policy during such client's lifetime, it may still be possible to indirectly obtain such benefits for the insured since the spouse is still a lifetime beneficiary
- It may even be an option to have the spouse obtain the policy back during the insured's lifetime if necessary but which usually requires the consent of an independent trustee
  - This technique is sometimes referred to as the Spousal Lifetime Access Trust (SLAT)

Spousal Lifetime Access Trust ("SLAT")

- Irrevocable trust FBO a spouse
- Can provide grantor, indirectly, with continued access to assets by allowing for discretionary distributions to the spouse
- A client's typical concern is loss of access in event of divorce or spouse's death while grantor survives. This concern can be alleviated by either providing spouse with a limited power of appointment (exercisable either alone or with consent of a non-adverse third party) or giving a third party the power to add the grantor as a beneficiary

Qualified Personal Residence Trust ("QPRT")

- Another tool to achieve tax savings is through a Qualified Personal Residence Trust (QPRT)
- A QPRT is an arrangement where the client gifts the "remainder" interest in a primary home or the vacation residence to desired beneficiaries but retains the "lead" interest for a term of years
- This allows the residence to be transferred to the beneficiaries at a substantial discount from the home's actual fair market value and also removes the value of the entire house from the estate tax base
  - Further, it removes future appreciation on the house

QPRTs

- For example:

A client places a beach property in a QPRT for a term of 10 years

The value of the residence is $850,000 at the time of the funding. The taxable gift by a 70-year-old client in December of 2023 to the remainder beneficiaries would only count as $354,152 and the potential estate tax savings could be significant.

Note that if a 6-year term was used in lieu of the 10 years, the taxable gift under the same example is increased to $521,211.

QPRTs

- Two considerations that need noting here:
  - The income tax basis would not be stepped up on the QPRT's termination; but
  - If the client dies during the term, the property is generally included in such individual's taxable estate.

QPRTs

- One option to get around the inclusion of the home in the taxable estate in the event of an early passing is to use a split purchase arrangement
  - Commonly the client and the client's child purchase a property together in which the present value of the lifetime interest of the parent is paid by the parent and the remaining value of the property is paid by the child
  - In such event, the property is not included in the parent's taxable estate since the parent did not pay for or gift the remainder interest

Creation of an LLC (or Similar Entity)

- If the client has investment properties or business interests, he/she may want to consider transferring them to a newly formed Limited Liability Company (LLC)
  - Sometimes this technique is referred to as the Family Limited Partnership or Family LLC arrangement but recently the selection of the LLC entity is more common
- This converts the investment assets to business interests

Benefits of an LLC (or Similar Entity)

- The subsequent transfer of a Membership Interest to children or grandchildren will provide lower values than the pure percentage ownership of the transferred interest based on the use of discounts
    - Because of a lack of marketability and lack of control in the transferee, a transfer of say 10% of a $1 Million LLC entity value is worth only $65,000 or $70,000 (as determined by an appraiser), rather than $100,000

Benefits of an LLC (or Similar Entity)

- Thus, the client can effectively shift ownership interests to younger generations while simultaneously minimizing the taxes associated with the transfer
- However, there are still ways to retain benefits in the LLC for the client
- Even with such retained benefits, it is often best to have a child (or multiple children) act as managing member(s), or at least as a co-manager, rather than solely the clients who funded and gifted the interests

Benefits of an LLC (or Similar Entity)

- The value of these interests would be removed from the client's estate at their later death
- All the members of the LLC will enjoy limited liability
  - Note limitation under IRC Sections 1014(f) and 6035 which require restrictive reporting conditions under Form 8971, which have added new consistency rules to show that the discounted values for basis purposes reflected on the Estate Tax Returns are similarly provided on the applicable recipient's income tax returns

Intentionally Defective Grantor Trust (IDGT)

- A grantor trust is any trust over which the one who generally creates the trust has such control that such individual is deemed to be the owner of the trust property or a portion of the trust property for income tax purposes
- An intentionally defective grantor trust (IDGT) is "defective" for income tax purposes because the client remains responsible for the income tax burdens and consequences of the trust even though the transferred property to the trust beneficiaries is deemed to be complete for gift and estate tax purposes
  - This "mismatch" gives rise to defective nature of grantor trust

Intentionally Defective Grantor Trust (IDGT)

- From a tax perspective, defective trusts are a very effective estate planning tool
    - Any appreciation in value of the trust assets occurs within the trust tax free to the benefit of the trust beneficiaries
    - The client's taxable estate, for estate tax purposes, is reduced by the client paying the income taxes on the trust assets
    - Some planners believe the payment of income taxes by the Grantor is more valuable than the discounts

Intentionally Defective Grantor Trust (IDGT)

- By creating a trust that is defective for income tax purposes, the grantor is required to pay the income tax on the income of the trust and essentially maintain its value without reduction for the income taxes paid
- An added benefit: no gift results when the grantor pays the income tax on the income of the trust
  - These tax-free gifts to the beneficiaries will also reduce the client's gross estate

Intentionally Defective Grantor Trust (IDGT)

- Combining the use of an IDGT with the transfer of a discounted Membership Interest in an LLC can make this technique even more powerful as a means to save on estate taxes

Charitable Planning Techniques

Charitable Remainder Trust (CRT)

- Another planning tool to reduce the potential estate taxes due at the client’s death while ensuring a portion of their assets pass to descendants (or a spouse) is known as a charitable remainder trust (CRT)
- This planning tool can be used in conjunction with a Private Foundation set up by the client and run by such person and/or their descendants to support their favorite charities or Donor Advised Fund

Charitable Remainder Trust (CRT)

- The general objective with a CRT is
  - To diversify asset holdings;
  - potentially defer capital gains tax;
  - benefit a charity; and
  - maintain benefits for the client or desired beneficiaries
- The trust provides a fixed payment stream to family members over a specified term and then distributes the remaining assets to charity at the end of the payment term

Charitable Remainder Trust (CRT)

- The CRT is an irrevocable trust to which a grantor transfers assets
  - CRT makes a fixed payment (usually expressed as a percentage of trust assets), at least annually, to client and/or client's family members for a specified term
- If anyone other than the grantor is to receive payments from the CRT during the payment term, then there is a gift to such person equal to the present value of that person's payment stream, computed by using the applicable government determination for such time period (the 7520 rate)

Charitable Remainder Trust (CRT)

- The payments can last for lives or a term or years
  - The payment term also can have a duration that lasts for a fixed number of years not exceeding 20
- At the end of the payment term, the remaining trust assets will pass to the charity or charities designated in the trust agreement
- Sometimes the power to change the designated charity(ies) is retained by the grantor

Charitable Remainder Trust (CRT)

- With all CRTs, one can choose the desired payout percentage subject to the following rules:
  - The payout percentage cannot exceed 50%;
  - The payout percentage cannot be less than 5%; and
  - The payout percentage cannot result in there being less than 10% (based on present value calculation) of the trust property remaining for charity at the end of the payment term

Charitable Remainder Trust (CRT)

- There are two types of CRTs:
  - The Charitable Remainder Annuity Trust (CRAT)
    - payments are essentially a fixed amount
    - not as favorable in times such as now when interest rates are very low
  - The Charitable Remainder Unitrust (CRUT)
    - the annual payout is based on a fixed percent of the CRUT's then determined value

Private Foundation

- By forming a Private Foundation the client creates a charitable-giving entity that provides the donor and/or the donor's family with grant-making and managerial/investment control over the assets held in the Private Foundation

Private Foundation

- In general, a Private Foundation is a tax-exempt charitable entity typically established by a single donor or family wishing to maintain control over substantial charitable contributions
  - It is managed by trustees or directors appointed by the donor (e.g., the donor who is joined or succeeded by family members)
  - A Private Foundation is required to make annual charitable grants equal to a minimum of 5% of its investment assets

Private Foundation

- A Private Foundation can be structured as a trust or not-for-profit corporation
  - The trust format may limit a foundation's flexibility since the terms of the trust are generally irrevocable
  - On the other hand, the irrevocable nature of a trust can help preserve the donor's desired charitable mission for the foundation
  - Using a not-for-profit corporation may create greater flexibility since the certificate of incorporation and by-laws can be amended if circumstances change
  - Yet such flexibility could result in the modification of the donor's charitable mission

Private Foundation Benefits

- If the donor creates a Private Foundation during his or her lifetime, the donor will receive a federal charitable gift tax deduction and potential federal and state charitable income tax deduction that may be equal to the value of his or her contribution;
- If the donor creates a Private Foundation at death, the donor's estate will receive a federal charitable estate tax deduction equal to the value of his or her contribution;

Private Foundation Benefits

- The donor and/or the donor's family can have grant-making and managerial/investment control over the Private Foundation's assets – a Private Foundation can provide the younger generation with a future managerial role;
- A Private Foundation's managers (including family members) can be paid reasonable fees for their services;

Private Foundation Benefits

- Contributions of appreciated assets to a Private Foundation are not subject to capital gains tax;
- Contributions to a Private Foundation can help reduce the size of the donor’s estate; and
- Helps the family continue stated charitable giving goals after the client’s death

Private Foundation Disadvantages

- Generally, there are operating costs (legal and accounting expenses) and administrative complexities involved with creating and maintaining a Private Foundation;
- A Private Foundation is subject to various excise taxes under certain circumstances (e.g., if it fails to make annual distributions equal to 5% of its net investment assets or engages in certain prohibited self-dealing transactions with the donor or the donor's family) and the 1% or 2% tax on net investment income;

Private Foundation Disadvantages

- For purposes of the 5% annual distribution rule, a Private Foundation is not permitted to count as qualifying distributions its payments to certain supporting organizations; and
- Contributions to a Private Foundation are irrevocable and nonrefundable so neither the donor nor the donor's family can decide to terminate the foundation and take back its remaining assets

Donor Advised Fund

- A Donor Advised Fund (DAF) is a planning tool that creates an efficient charitable-giving vehicle that provides some of the benefits of a private foundation
- Recent changes in the law have made the DAF subject to similar restrictions imposed on a Private Foundation

Donor Advised Fund

- The DAF is a fund held by a sponsoring charity to which a donor makes an irrevocable, nonrefundable contribution
  - Fidelity, Schwab, Merrill Lynch, Community Foundations, and other entities make this option available to a donor

Donor Advised Fund

- The sponsoring charity maintains legal control over the client's contribution but the client can make non-binding recommendations as to which qualified charities (i.e., the DAF's sponsoring organization, another DAF, or domestic public charities other than certain supporting organizations) should receive grants or distributions from the DAF

Donor Advised Fund

- The client can also:
  - Recommend the timing and amount of such distributions
  - Appoint others to recommend payments to charities concurrently and/or following the client's passing
  - Request the manner in which the sponsoring charity implements an investment strategy for the contribution

Donor Advised Fund Benefits

- The one funding the DAF receives a federal charitable gift tax deduction and potential federal and state charitable income tax deduction that may be equal to the value of the contribution;
- Contributions to a DAF may provide a greater charitable income tax deduction than contributions to a private foundation - contributions to a DAF are treated as made to a public charity for federal income tax purposes;

Donor Advised Fund Benefits

- Contributions of appreciated assets to a DAF are not subject to capital gains tax;
- Contributions to a DAF can help reduce the size of the client’s estate;
- Unlike a private foundation, a DAF is not required to make annual distributions equal to 5% of its net investment assets;

Donor Advised Fund Benefits

- DAF generally does not have the costs (legal and accounting expenses) or administrative complexities involved with creating and maintaining a private foundation;
- Unlike a private foundation, a DAF is not subject to an excise tax of 1% or 2% on its net investment income; and
- The client can choose anonymity or public recognition on distributions from a DAF

Donor Advised Fund Disadvantages

- The client does not retain any legal control over contributions to a DAF;
- A sponsoring charity may prohibit a DAF from making grants to public charities with which its staff is unfamiliar or may limit the DAF's payments to charities that support certain beliefs or activities;

Donor Advised Fund Disadvantages

- Contributions to a DAF are irrevocable and nonrefundable so the clients and their families cannot decide to terminate the DAF and take back its remaining assets, which is similar to the impact of a Private Foundation; and
- Recent laws impose certain restrictions on DAF's such as not permitting the $100,000 lifetime allocation of a Minimum Required Distribution in any year to be distributed to a DAF

Qualified Charitable Distributions ("QCDs")

- QCD = tax-efficient way for taxpayers 70 ½ years and older to donate funds from their IRA to a qualified charitable organization
- Under prior QCD rules, an individual could directly transfer up to $100,000 per year from their IRA to a qualified charity without incurring taxes on the distribution. The donated funds count towards the individual's required minimum distribution (RMD) for the year. For married couples, if both spouses are 70 1/2 or older and have IRAs, each spouse can exclude up to $100,000 for a total of $200,000 per year.

Qualified Charitable Distributions ("QCDs")

- Secure 2.0 Act changes
  - Starting in 2023, QCDs of up to $50,000 can be transferred from a traditional IRA to a split-interest entity (e.g., CRTs or charitable gift annuities) that will pay a 5% minimum fixed percentage over the life to the donor or their spouse. Note that this transfer can only be made once during a single tax year for a maximum of $50,000. Smaller amounts can be combined to reach the $50,000 limit for such year. The $50,000 cap will be adjusted for inflation for tax years after 2023.
  - Beginning in 2024, the $100,000 maximum QCD amount will be annually indexed for inflation.

Hiring and Firing

Job Descriptions

Job descriptions provide a basis to advertise for and evaluate prospective candidates.

They also assist employers throughout the employment relationship and help the applicant understand the responsibilities of the position.

Job descriptions should provide a complete, accurate and clear representation of the position.

Job Descriptions

- Name of the job
- Job summary
  - A brief narrative of the job describing in action words the general characteristics of the position.
- Essential functions of the position
  - The essential functions of the position should include day-to-day functions as well as duties that occur at irregular intervals but that are reoccurring and essential.
  - Essential functions are duties an individual must be able to perform, with or without reasonable accommodation. Having a written and accurate job description is useful in determining whether someone is qualified to perform a job for purposes of The Americans with Disabilities Act.
- Job accountabilities
  - Accountabilities of the job should describe the standards for measuring job performance.
- Job specifications
  - Job specifications should describe the job requirements such as experience and education.

Advertising

An advertisement for a position typically provides the name of the employer, the key requirements for the position and contact information.

- What to stay away from in advertising the job
  - Employers are prohibited from making hiring decisions based on protected characteristics. Generally, employers should not express any preference for race, color, sex, national origin, religion, age or disability or any other protected characteristic. An employer may express a preference for a protected characteristic if the position satisfies the bona fide occupational qualification (BFOQ) exception. For example, a manufacturer of men's clothing can lawfully advertise for male models.

Application/Interview

The application and interview should be designed to elicit only the information needed to evaluate an applicant's qualifications for the position.

- The application and interview should avoid:
  - Asking about protected characteristics. An employer does not need to know an applicant's race, color, national origin, gender or age to evaluate if he/she is suitable for the position.
  - Asking an applicant's date of graduation because the answer could reveal the applicant's age.
  - Inquiring about marital status or dependents. Do not ask any question like "do you have a maiden name" or "do you plan on having a family" or "do you have child care arrangements?"
- Inquiring about medical information. Avoid questions regarding a disability, past use of sick leave or family leave or workers compensation claim history.
- Inquiring whether or not an applicant is able to work on any religious holidays.
- Inquiring about language skills or fluency unless a specific language is necessary for the position.
- Inquiring about the birth place or citizenship of an applicant.
- Asking about an applicant's prior salary.
- Inquiring about an applicant's arrest record and/or convictions on an application.

Application/Interview

- What is “Ban the Box”?
- The box typically found on an employment application in which applicants are asked about any prior convictions
- Applies to employers in (i) Maryland with more than 15 employees (i) Montgomery County with more than 1 employee; (ii) Prince Georges County with more than 25 employees; and (iii) Baltimore City with more than 10 employees.
- At the state level you can inquire about an applicant’s criminal history during the first in person interview but not before. In Prince Georges County you may not inquire about an applicant’s criminal history until after the first interview. In Montgomery County and Baltimore City, you may not inquire about an applicant’s criminal history until after a conditional offer of employment is made.

Application/Interview

- Lie Detector Provision
  - In Maryland, all applications for employment must contain the following notice in boldface, uppercase type:
  - UNDER MARYLAND LAW, AN EMPLOYER MAY NOT REQUIRE OR DEMAND, AS A CONDITION OF EMPLOYMENT, PROSPECTIVE EMPLOYMENT, OR CONTINUED EMPLOYMENT, THAT ANY INDIVIDUAL SUBMIT TO OR TAKE A LIE DETECTOR OR SIMILAR TEST. ANY EMPLOYER THAT VIOLATES THIS LAW IS GUILTY OF A MISDEMEANOR AND SUBJECT TO A FINE NOT EXCEEDING $100.
- EEO Statement
  - It is the policy of the Company to provide equal employment opportunity (EEO) to all persons regardless of age, color, national origin, disability, race, religion, gender, sex, sexual orientation or any other Protected Characteristic pursuant to Federal, state or local law.

Application/Interview

- Reference Checks
  - If an employer desires to conduct reference checks, it should have a statement that employment is conditioned upon the results of reference checks and that the employer is authorized to investigate all statements made by the applicant on the application.
  - Some employers are reluctant to provide information about former employees for fear of being sued by those employees for defamation if they give a “bad” reference. In Maryland, an employer acting in good faith in communicating information about position performance or the reason for termination of an employee in response to a request from a prospective employer has a legal defense against such liability. It is presumed that the communications from an employer to a prospective employer are made in good faith. However, this good faith presumption can be rebutted by demonstrating that the employer acted with actual malice toward the employee or former employee or intentionally or recklessly disclosed false information about the employee or former employee. Those actions must be proven by clear and convincing evidence in order to rebut the presumption. To be safe, many employers provide only dates of hire and termination, position held, and/or salary prior to termination.

Offer Letter

The offer letter should provide that an offer of employment is being made and should contain only those items that are necessary to allow the applicant to make a determination as to whether he or she will accept employment. For example, an offer letter should include starting salary, whether the employee will be an exempt or non-exempt employee, the days and hours of work, benefits offered and eligibility and whether or not the offer of employment is conditional.

- Conditional Offer/At-will Employment
  - Employment may be conditioned on the following:
    - successful completion of physical exam and/or drug testing
    - successful completion of background or reference checks
    - execution of a restrictive covenant agreement
    - If applicable, the offer letter should include a statement that employment is "at-will" and that the offer letter does not constitute a contract of employment

At-Will Employment

The general rule in Maryland is that all employees are at will, which means that either the employee or employer may terminate the employment relationship at any time with or without cause and with or without notice.

- Exceptions
  - Employment Contract. A written employment contract may alter the at will doctrine by providing specifically that the employment relationship may not be terminated except under circumstances set forth in the contract.
  - Protected Characteristics. An employee may not be terminated due to any legally protected characteristics.
  - Wrongful Termination. An employee may not be terminated in violation of any public policy.

Background Checks

Background checks are designed to seek information that will provide the employer with some insight into the employee’s general character and suitability for a particular position. The types of information elicited through background checks include criminal and civil record information, driving records, credit history, verification of education and past employment, verification of professional licenses, reference checks, bankruptcy and military service records.

Background Checks

- Types of Background Checks Conducted by Third Parties

  Some employers conduct their own background checks. While this may save costs, it is quite time consuming. Therefore, most employers now use third parties to conduct background checks on their behalf. When an employer uses a third party "consumer reporting agency" to conduct background checks, such "consumer reports" are subject to the Federal Fair Credit Reporting Act ("FCRA").

  - Consumer Reports provide general financial and personal data about an individual. The employer must disclose to the applicant, in writing, that a consumer report may be obtained for employment purposes. This disclosure must be a separate stand-alone document that is not part of the employment application. The document must be signed by the applicant to authorize the background check.

- Investigative Reports provide more in-depth information about an individual's character and reputation. This information is usually obtained through interviews with neighbors, friends and professional associates.
  - In addition to the disclosure and authorization for a consumer report, the employer must also disclose to the applicant, in writing, that the applicant has a right to request additional disclosures and to receive a written summary of his or her legal rights. The disclosure must be mailed or otherwise delivered to the applicant no later than three (3) days after the report is requested. If an applicant does request additional information about the nature and scope of the investigation, an employer must mail or otherwise provide the information within five (5) days of receipt of the written request or the request date of the report, whichever is later.

Background Checks

- Before Any Adverse Action is Taken By Employer
  - An employer must provide a copy of the report as well as a written statement of the applicant's rights under law.
  - If adverse action is taken, the employer must give notice of the adverse action to the person, provide the name, address and telephone number of the consumer reporting agency that provided the report, as well as a statement that the consumer reporting agency did not make the adverse decision and cannot provide the applicant with specific reasons supporting the action, that the person has a right to obtain a free copy of the report, and that the person has the right to dispute the accuracy or completeness of the report.

Background checks

- Credit Check
  - The Job Applicant Fairness Act prohibits Maryland employers from obtaining or using credit reports to deny employment to an applicant, terminate an employee, or set the terms and conditions of an individual's employment except in limited circumstances. Financial institutions, credit unions, certain investment advisors, and entities required by law to obtain credit reports are exempt from this law. All other employers in Maryland must have a bona fide job related reason for obtaining a credit report which must be disclosed in writing to the applicant or employee. A job related reason exists when the position for which the individual applied meets one of five criteria:
  - (1) The position is at the managerial level and involves setting the direction of the business or a department or unit within a larger business;
  - (2) The position involves access to certain personal information of customers or employees such as social security numbers or financial account numbers, provided that the personal information is more detailed that what is customarily provided in a retail transaction;
  - (3) The position involves a fiduciary responsibility to the employer, including the authority to make payments, transfer money, or enter into contracts;
  - (4) The position requires that the employee hired will be provided with an expense account or a corporate debit or credit card; or
  - (5) The position involves access to the employer's trade secrets or other confidential business information.

Drug and Alcohol Testing

If an employer decides to implement a drug and alcohol testing program, it should develop a uniform policy. The policy should provide, in writing, that employees may be subject to discipline and/or termination if they are found under the influence of drugs or alcohol during worktime. Likewise, the drug and alcohol policy should provide that an employee is not permitted to retain, in his/her possession, any related alcohol or drug paraphernalia.

Drug and Alcohol Testing

- When can you test
  - An employer's policy should also inform the employee when the test will be conducted. Employers may require testing as a condition of employment. Employers may also conduct random drug testing or when there is an issue or accident. The policy should also state what type of test is going to be administered, i.e, urine, blood, breathalyzer, hair or saliva. In Maryland, the specimen tested must be done by a licensed laboratory. Additionally, at the time of testing, the applicant or employee must be provided with the name and address of the laboratory if they so request.
- Who should you test
  - New Employees
  - Random Selection
  - Specific positions; or
  - As a result of an accident or concern
- What do you do with a positive result
  - If the results are positive, the applicant or employee must be provided with a copy of the results, a copy of the employer's substance abuse policy, written notice of any action the employer intends to take, and notice of the employee's right to have the specimen retested at his or her own expense. This information must be provided either in person or by certified mail within thirty (30) days of the testing.

Restrictive Covenants

A restrictive covenant is an agreement between an employer and an employee whereby the employee agrees to take, or not take, certain action during and/or after employment. The most common types of restrictive covenants are confidentiality, non-competition and non-solicitation agreements.

- Confidentiality
  - A non-disclosure or confidentiality provision provides that the employee agrees to hold in strict confidence and not use or disclose any confidential information of the employer.
  - Confidential information should be defined broadly to protect the employer. For example, it should include all information relating to the company, not in the public domain, and treated as confidential by the company. An employer may require an employee to maintain the confidentiality of company information indefinitely.

Restrictive Covenants

- Non-Solicitation of Clients and Employees
  - A non-solicitation provision provides that during employment and thereafter for a period of time the employee agrees not to solicit any employees and/or customers of the employer. These provisions should be reasonable in duration to maximize enforceability.
- Non-Competition
  - A non-competition provision provides that during employment and/or thereafter for a period of time the employee agrees not to work for a competitor within a certain geographical area.
  - Careful drafting of non-compete provisions is critical. To be enforceable, non-competition provisions generally must be: (i) narrow in scope to protect only the employer's legitimate business interests; (ii) reasonable in geographic area; and (iii) reasonable in duration. Whether the scope is appropriate depends on the nature of the business. A geographical scope is reasonable if it is related to the employer's business and the employee's capacity within that business. The determination of whether a geographical scope is reasonable is made on a case by case basis and there is no blanket rule about what is an appropriate area. The analysis is the same for the duration of the restriction.

Exit Meeting

The exit meeting is strictly voluntary and is typically held on the last day of the employment relationship. The meeting helps the employer understand why the employee terminated the relationship so as to improve its employee retention and employee morale going forward.

- Company Property. Employer will request that employee return any and all company property in his or her possession.
- COBRA
  - The Consolidated Omnibus Budget Reconciliation Act ("COBRA") applies to employers who have 20 or more employees on more than 50% of business days during the prior calendar year. COBRA requires group health plans sponsored by covered employers to allow a qualified beneficiary who would otherwise lose group health coverage upon the occurrence of certain qualifying events to continue such coverage at the beneficiary's own expense.
  - Many states have mini-COBRA laws as well. Maryland has a health insurance continuation law that applies to all employers regardless of size.

Parting Payments

Parting payments are monies due to an employee at the end of the employment relationship.

- Final Paycheck. Maryland law requires that the departing employee receive his/her final paycheck and all wages owed to him/her either at the time of termination or on the next regularly scheduled payroll date of Employer.
- Accrued but unused paid time off. Employers must pay to employees at the time of termination all of his/her accrued but unused paid time off/vacation leave UNLESS the Employer has a written policy that states otherwise, and Employer has communicated this at the onset of the employment relationship.
- Severance. Maryland law does not require that severance be paid; however, employer may have a policy providing for severance or it may offer severance to employees, conditioned on signing an employment release.

Unemployment Benefits

Unemployment insurance benefits are paid to employees who have lost his/her job through no fault of their own and meet the eligibility requirements pursuant to Maryland law.

- Good Cause.
  - If an employee quits with good reason he or she will be entitled to benefits. An example of good reason may include resigning due to being sexually harassed or asked to falsify documents.
- Simple Misconduct.
  - If employee was discharged for simple misconduct he or she may be denied benefits for a certain number of weeks from his/her last day of work. An example of simple misconduct may indicate being tardy or otherwise late on assignment.
- Gross Misconduct/ Aggravated Misconduct.
  - If employee was discharged for gross or aggravated misconduct, benefits will be denied. Examples of gross or aggravated misconduct include assaulting another employee or stealing from the employer, or deliberate failure to follow established policies of the employer.

About Stein Sperling

Stein Sperling, founded in 1978, provides a broad range of services to meet the business and personal needs of a broad range of clients. Our focus is on a team approach and our flexible and dynamic organizational structure offers our clients the benefit of our full range of legal resources in the following practice areas:

Business Law, Family Law, Civil Litigation, Injury Law, Criminal Law, Real Estate Law, Employment Law, Tax Law and Estates & Trusts

US News and World Report awarded Stein Sperling a Tier 1 National rating in 2024 for Tax Litigation and Controversy, one of only 36 Firms nationally to receive this designation.