1 p.m. – 2 p.m.

M&A Teamwork: The CPA, Investment Banker & Attorney

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Tim Oleszczuk, *Managing Director/Co-Founder, TKO Miller, LLC*

John Sikora, J.D., *Shareholder, von Briesen & Roper, s.c.*

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Maggie Bafia is a Senior Manager specializing in mergers and acquisitions tax consulting. She has worked closely on numerous transactions with complex tax issues arising from transactions and other M&A activities including a variety of transactions to assist clients with buy- and sell-side due diligence, tax structuring and modeling, merger integration and tax attributes analysis. Maggie has been involved in a variety of transactions across numerous industries. She has extensive experience with cross-border due diligence and structuring engagements, working directly with Grant Thornton International Ltd member firms in various countries, helping clients efficiently and effectively execute on multi-national transactions. Maggie is a Certified Public Accountant, and has a Bachelor of Business Administration in Accounting and Finance from Loyola University Chicago and a Masters of Science in Taxation from DePaul University.

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Tim Oleszczuk is a Managing Director and Co-Founder of TKO Miller, LLC. Tim specializes in middle-market mergers and acquisitions with an emphasis on advising family-and founder-held companies during the business sale process. Prior to co-founding TKO Miller, Tim was a Managing Director and General Counsel at Grace Matthews, a leading Milwaukee-based boutique investment bank. During this time, he focused primarily on the manufacturing and industrial service sectors. While there, he completed nearly 20 deals for one of the largest scaffolding companies in the U.S., and established himself as one the of premier dealmakers within those sectors. Tim has advised on transactions totaling approximately $3 billion in aggregate value. Prior to Grace Matthews, Tim was a shareholder at Godfrey & Kahn, S.C., where he and his team focused on mergers and acquisitions, corporate finance, and insurance law.

3

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John Sikora is a Shareholder in the Tax, Real Estate and M&A sections at von Briesen & Roper, s.c. He represents clients in tax planning and the buying and selling of businesses and real estate. John has taught the tax practice and procedure course and the corporate income tax course at Marquette University Law School and the taxation of partnerships and S corporations course at the University of Wisconsin-Milwaukee masters program. He has been a frequent presenter to the State Bar of Wisconsin and the WICPA, has presented to the ABA Tax Section, has authored articles for the Journal of Taxation, Journal of Real Estate Taxation, TAXES – The Tax Magazine and other tax publications. He is a former chair of the Board of Directors of the State Bar of Wisconsin Taxation Section, a former editor of the *Wisconsin State Bar Tax News,* has been included in *The Best Lawyers in America*®, Tax (2003-2023), and was named Best Lawyers® Tax "Lawyer of the Year", Milwaukee for 2013.

4

Approach/Objectives

- Timeline of a deal
- Tax considerations along the way for taxable deals
- The team - CPA, investment banker, attorney
- Working together to further client tax-related objectives – seller side, buyer side
- Observations, recommendations regarding critical role of CPA throughout timeline

5

Timeline

- Preparing to market
- NDA
- Letter of intent
- Due diligence
- Definitive agreement
- Closing (and potential pre-closing restructuring)
- Post closing matters/reconciliations/liquidation

6

Preparing to Market - 1

- Value generally – ongoing during life of business, not just when deciding to sell
- Value as to tax matters
- Seller side - calculating correct outside basis of each owner in each entity – seemingly straightforward, but in some situations may require more analysis
- Review of typical tax representations and warranties (see later slides) can aid CPA in identifying tax items to address before buyers are sought. Some examples:
  - If S corporation, review of records for potential prior termination issues - e.g.:
    - Failures to sign S election – e.g., spouses in community property states
    - Ineligible shareholders over time
    - Inappropriate governing documents – e.g., providing for distributions other that based on share ownership
    - Improper/disproportionate distributions
    - Section 1362(d)(3)

Preparing to Market - 2

- Review of typical tax representations and warranties (see later slides) can aid CPA in identifying tax items to address before buyers are sought. Some examples - continued:
  - Nexus/state filing issues
  - Notices from tax authorities
  - Potential or past S corp tax liabilities - Sections 1374, 1375
  - Past audits; closing agreement requirements
  - Potential audit issues
  - Independent contractor/ee issues
  - Prior acquisitions/purchases of 197 assets

If C Corp, Potential 1202 Benefit?

- Can help to assess early, particularly if many seller shareholders
- CPA/others work together to evaluate potential applicability and degree
- Section 1202
  - Allows for exclusion of gain from sale of certain stock held more than 5 years; portion of gain excluded depends on when acquired
  - General requirements
    - C corporation stock
    - Type of shareholder
    - Original issuance
    - Exchange for money, property or as compensation
    - Active business requirement
    - $50M gross asset limitation
    - Certain types of businesses excluded
    - $10M/10 times adjusted basis limitation per shareholder
    - Other

EOI/LOI – Some Initial Big Picture Inquiries

- What is essential nature of potential deal?; price?; what is being purchased? is there any real estate that is part of deal?
- The whole or part of a business?; will there be excluded assets?
- What are the seller entities?
- What are tax natures of seller(s), buyer?
- Might sellers retain interest in business after acquisition?; if so, do sellers expect to do so on tax deferred basis?
- Expected to be entity acquisition or asset acquisition from legal perspective?; what is prompting that expectation?
- Is there any reason parties will not be able to agree on purchase price allocation at LOI stage?

Early Tax Related Calculations – Seller Side - 1

- Important early step seller side – CPA lead – "walk away money" calculation
- Aids seller side in evaluating alternative buyer proposals, structuring, planning and evaluation in negotiations, and as negotiations progress, things change, detail determined; should be tailored to the situation; see allocation discussion in later slides
- Entity sale deal template - if C corp or S corp stock
  - Start with gross purchase price; allocate it among sell side entities
  - Adjust for estimated closing funds flow items – e.g.:
    - Transaction expenses
    - Funded debt
    - Working capital excess or deficit
  - Equals net purchase price to be paid to shareholders for stock of various entities
  - Allocate such amount among shareholders; subtract outside basis of each shldr
  - Apply applicable tax rates – capital gain federal and state; NIIT; potential 1202 benefit – to calculate tax on gain for each shareholder
  - Summary page – net cash at closing to each shareholder, tax to each shareholder, net after tax cash to each shareholder

11

Early Tax Related Calculations – Seller Side - 2

- Entity sale deal template - if disregarded entity or tax partnership
  - If disregarded entity – sell side and buy side - treated as asset sale, but without need to calculate liquidation step for sell side (see later slide)
  - If tax partnership (all interests acquired) – Rev. Rul. 99-6, Situation 2
    - Buy side – purchase of assets following deemed liquidating distribution of assets to existing tax partners
    - Sell side - sale of interests; Sections 741 and 751 applicable
      - Start with gross purchase price, with adjustment for potential working capital excess/deficit; allocate it among sell side entities
      - Allocate result among assets of the entities
      - Apply Section 751 principles to determine ordinary income item/amounts
      - Adjust for each owner's share of expected closing funds flow items (see exps. prior slide)
      - Apply applicable tax rates – capital gain to 741 portion and ordinary to 751 items
      - Summary page - net cash at closing to each owner, tax to each owner, net after tax cash to each owner

12

Early Tax Related Calculations – Seller Side - 3

- Asset sale deal template – usually involves determining tax consequence of asset sale and then of liquidation (or deemed liquidation) of each entity
  - Start with gross purchase price, and provide for potential working capital excess/deficit modification; for tax calculations, add estimated debt to be assumed by buyer, including current liabilities assumed in connection with working capital aspect of deal
  - Allocate result among sell side entities
  - Allocate amounts allocated to each entity among assets of the entity, and determine adjusted basis of the various assets to which purchase price has been allocated
  - Calculate gains or losses of sales on various assets (taking into account also expenses of sale of each entity)
  - Determine character (if entity is pass through entity) of gains and losses
  - For other than pass through entities, apply applicable federal and state tax rates to determine tax amounts, if any, due from entity (and, if S corp and applicable, 1374 tax)

13

Early Tax Related Calculations – Seller Side - 4

- Asset sale deal template - continued
  - Allocate (for each pass through entity) total gains and losses, by category (capital/1231, ordinary, unrecaptured 1250 gain) among the owners of the entity
  - Calculate the resulting outside basis of each owner for the entities that are pass through entities after such allocation of total asset sale gain/loss to each owner
  - Next (moving to liquidation step)
  - Calculate distribution to be made to each owner of each entity after payment of all entity obligations not assumed by buyer and any entity level taxes
  - Determine capital gain or loss on liquidation to each owner on liquidation of each entity (liquidating distribution minus outside basis in interest)
  - If entity is pass through entity, net the capital gain or loss upon liquidation and the capital/1231 gains from asset sale flow throughs

14

Early Tax Related Calculations – Seller Side - 5

- Asset sale deal template - continued
  - Next (moving to shareholder tax calculation step)
  - For other than pass through entities, apply applicable state and federal capital gain tax rates to liquidation gain, if any, to determine tax for each owner of each such entity
  - For pass through entities, apply applicable federal and state capital gain, ordinary, and unrecaptured 1250 gain tax rates to overall income and gain amounts of each owner from combination of items passed through and resulting from liquidation, to determine tax for each owner of each such entity
  - Next (moving to summary step), summarize amount available for distribution to shareholders, shareholder tax and net cash to shareholders

Early Tax Related Calculations – Buyer Side - 1

- Buyer side template is tool to evaluate: effect of purchase price allocations; effect of purchasing interests in a corporate tax entity without deemed asset sale treatment (discussion in later slides); potential gross up (see later slides)
- Aids buyer side in evaluating alternative seller proposals, structuring, planning and evaluation in negotiations, and as negotiations progress, things change, detail determined; should be tailored to the situation; see allocation discussion in later slides
- Buyer deal template
  - Start with gross purchase price, including assumed liabilities; allocate it among sell side entities
  - Identify assets held by each
  - Allocate purchase price allocated to the entity among those assets
  - Using such allocations, determine depreciable/amortizable lives of the various assets, and calculate expected depreciation deduction for assets in each year

Early Tax Related Calculations – Buyer Side - 2

- Buyer deal template - continued
  - Determine assumed tax rate that will apply given buyer tax entity status for each such year, and apply that tax rate to the expected depreciation/amortization deduction in each year to determine expected tax benefit of depreciation/amortization for each year
  - Calculate present value of those tax benefits
  - Result will be referred to below as “PV Depr at FMV”
  - Then, identify seller entities that are taxed as corporations
  - Identify assets held by each
  - Using adjusted basis of seller corporation in those assets, calculate expected depreciation/amortization deduction for those assets in each year

17

Early Tax Related Calculations – Buyer Side - 3

- Buyer deal template - continued
  - Determine assumed tax rate that will apply given buyer tax entity status for each such year, and apply that tax rate to such expected depreciation/amortization deductions in each year to determine expected tax benefit of depreciation/amortization for each year
  - Calculate present value of those tax benefits
  - Add present value of tax benefits from PV Depr at FMV for entities other than those corporations
  - Result will be referred to below as “PV Depr Without Asset Sale Election”
  - Subtract PV Depr Without Asset Sale Election from PV Depr at FMV
  - Result is difference in value to buyer between entity purchase (without any deemed asset sale elections discussed in later slides) and asset purchase transaction

18

Will/should Asset Sale Deal Include a Gross Up - 1

- The results of this early work commonly shows that the net amount to the seller side owners from a sale of stock will exceed net amount to them from an asset sale or deemed asset sale (see later slides); the seller calculations will show the magnitude of the difference, and sellers will normally want stock sale and not asset sale transaction; buyers will typically not want to forego the value of a deal structured entirely as asset deal, the magnitude of which will be disclosed by its calculations
- Conflicting desires often resolved by buyer agreeing to make an additional payment to the sellers so that seller owners are in the same net cash position from the deal as if there had been a stock sale or transaction in which only capital gain had been recognized (such additional payment, a "gross up")

19

Will/should Asset Sale Deal Include a Gross Up - 2

- Because the gross up will be additional purchase price, it will be also be taxable; accordingly, if there is to be a gross up, it is common for the amount of the additional payment from buyer to include the additional tax on the gross up (that portion, sometimes referred to as a "gross up on the gross up")
- Issue should be discussed in connection with evaluation of proposals from buyers; may be differentiating factor as between potential buyers; reply from some prospective buyers to seller request for gross up is that deal was priced on assumption it would result in full basis step up for buyer
- Complicating factors/items to be addressed:
  - Text of definitive agreement will typically refer to difference in tax or difference in net cash to seller owners determined by comparing a stock sale and an asset sale; without more, such text may produce uncertainty regarding how calculation to be done and when

20

Will/should Asset Sale Deal Include a Gross Up - 3

- Complicating factors/items to be addressed - continued
  - Other uncertainty sometimes existing regarding intent of parties as to gross up calculation – e.g., whether other seller tax attributes should affect calculation; whether seller side benefit from state SALT deduction limitation workarounds should be considered; whether and how Section 199A should apply; whether and how net investment income tax should apply; what if the seller is on the cash method of accounting and has significant receivables – should the buyer in effect bear burden of same in the gross up calculation?
  - Solution – CPA should prepare spreadsheet that is incorporated in definitive agreement showing detailed methodology for calculation of gross up
  - Alternative – address some of the uncertainties in definitive agreement text
  - Alternative – agree on specific gross up amount at time of definitive agreement, with no later adjustment; parties will then each assume some risk the amount will differ from actual that would have been calculated

Deemed Asset Sale – 338(h)(10) or 336(e) - I

- If the deal involves a purchase of at least 80% of the stock of a C corp subsidiary or the stock of an S corp, another EOI/LOI stage consideration will be whether buyer seeks deemed asset sale treatment under Section 338(h)(10)
- Results for income tax purposes in treatment of stock deal as deemed sale of assets of target to a new tax entity deemed to have been formed, followed by deemed liquidation of old target corp (so, stock sale is ignored for tax purposes, and asset sale issues such as gain/loss character, potential 1374 tax, etc. will apply)
- So, buyer will obtain benefit of purchase price basis in assets, as opposed to existing inside basis if no (h)(10) election made
- Requirements
  - Purchaser is corporation
  - Election made by shareholders of seller corporation and buyer

Deemed Asset Sale – 338(h)(10) or 336(e) - 2

- Section 336(e) election similar; unlike (h)(10), it may also be used in case of noncorporate purchaser
- Advantages of each over actual asset purchase are principally non-tax (e.g., avoiding of potential issues obtaining third party approvals regarding transfer of contracts, fewer conveyancing issues, etc.)
- However, non-tax and tax issues relating to purchase of stock remain for buyer (e.g., risk of undisclosed liabilities in corporation, including all tax obligations of entity)

F Reorganization - 1

- Now common approach (as opposed to 338(h)(10)) to achieve asset sale treatment for income tax purposes involving transfer of equity interests in sale of S corp business
- Term refers to initial steps in a pre closing restructuring intended to result in single member disregarded entity then purchased by buyer; See Rev. Rul. 2008-18
- Typical steps (first 3 are "F reorg steps")
  - Formation of new corporation ("Holdco")
  - Contribution by S shareholders of stock in existing S corp ("Oldco") to Holdco solely in exchange for stock in Holdco
  - Making of Qsub election for Oldco by Holdco, to be effective immediately after the contribution
  - State law conversion of Oldco to single member LLC; or formation by Holdco of new SMLLC and merger of Oldco into that new LLC
  - Buyer then purchases interests in disregarded LLC; asset purchase for income tax purposes if all interests acquired by buyer and Rev. Rul. 99-5, Situation 1 treatment if less than all interests acquired by buyer

F Reorganization - 2

- CPA involvement important in planning for and carrying out these steps in timely and correct manner over period of time before closing date; items (see Rev. Rul. 2008-18):
  - Obtaining of new EIN for Holdco (Oldco retains its EIN)
  - Filing of S election for Holdco; though the revenue ruling indicates that where, in connection with such F reorg, Holdco meets the requirements to be an S corporation, the reorg does not terminate the S election of Oldco and the S election remains in effect for Holdco, it is common practice to file a protective S election for Holdco
  - Making of Qsub election for Oldco by Holdco, to be effective immediately after the contribution; election must be made prior to Oldco converting to an LLC or merging into a new LLC, so election is done some number of day(s) before that step
  - If Oldco has made tax payments (such as under Section 7519 or to state), sell side CPA will want to work with counsel to include text in definitive agreement confirming seller ownership of such payments and work with taxing authority to get same moved to account of Holdco

25

Due Diligence – Tax Matters - 1

- Buy side CPA involvement in/leadership of tax due diligence
- CPA should seek prompt access to deal data room
- Typical representations and warranties tend to identify tax matters the CPA may be asked to review/address/understand
- Will vary depending on nature of deal/structure
- Examples of items/issues (and see seller list above):
  - Seller entities tax status
  - Seller S corporation election and confirming IRS documentation
  - Seller S corporation termination issues – see prior slides for types of issues
  - Seller entities tax accounting methods
  - Seller entities tax returns for obvious errors or omissions/disclosures
  - Target NOLs/other tax attributes
  - Potential for 1374 tax
  - Potential for 1375 tax
  - Prior acquisitions

26

Due Diligence – Tax Matters - 2

- Examples of items/issues - continued
  - Sufficiency of tax reserves, deposits
  - Sufficiency of information reporting
  - Property tax reassessment notices
  - Sales tax exemptions and exemption certificates
  - Potential international presence
  - Related party payments
  - Identity of affiliates
  - Tax sharing agreements
  - Tax obligations under third party agreements
  - Investments in pass through entities
  - If tax partnership, identity of partnership representative, and potential liability at entity level under partnership audit regime
  - Prior audits/settlement documents/closing agreements
  - Extensions of statutes of limitation
  - Prior federal, state, local tax notices

27

Due Diligence – Tax Matters - 3

- Common significant issue – nexus/state tax filings/voluntary disclosure
  - Buyer due diligence will include review target's business activity, including where sales occurring, employees located, property located, affiliates located, trade shows and other business generation activities occurring, etc.
  - Buyer may want some level of nexus study, comparing that activity to state sales and income tax reporting history; review should include how long target has filed in states; reference will be to physical presence or economic nexus
  - If potential filing requirements have not been met, buyer may ask for number of protections, including cooperation regarding filing of voluntary disclosure agreement applications and specific tax indemnity on subject and specific tax escrow, which will likely include seller obligation to pay fees for VDA work
  - If VDA is to be pursued, negotiation will follow regarding who is to do (usually buyer CPA firm), applicable states, deadlines for completion, seller VDA review rights, seller objection rights and dispute resolution

28

Definitive Agreement – Generally

- CPA should be asked to review tax provisions from earliest draft forward
- Typical sections for review:
  - Tax related definitions
  - Purchase price and purchase price adjustment
  - Gross up provisions
  - Purchase price allocation
  - Tax representations and warranties
  - Survival period
  - Tax covenants
  - Tax indemnity
  - Transfer tax
  - Tax escrow, if any
  - Tax controversy

Definitive Agreement – Tax Definitions

- Among potentially important tax related definitions typically in purchase agreement that CPA should review:
  - Tax – the text tends to be quite similar in all purchase documents; but, CPA should review closely, as used throughout document, often relating to seller responsibility for tax; so, buyer side will generally want to be sure definition is broad and includes, for example, all types of taxes, including foreign, federal and local, and that it includes penalties, additions to tax and interest
  - Pre-Closing Tax and Pre-Closing Tax Period or similar defined terms – the terms will be used in various provisions, significantly in the tax indemnity or other provision governing seller responsibility for tax; both sides should consider effect of authority regarding when tax years are deemed to end in reviewing these definitions
  - Tax Return
  - Transfer Tax

Definitive Agreement - Escrows

- Escrows are common in any type of transaction, most often used to secure for some period of time the accuracy of seller representations, warranties and covenants in favor of buyer; a tax question is whether the amount of the escrow is considered received by seller at time of closing; IRS view is that escrowed funds are deemed received by seller unless seller rights in escrow funds are subject to substantial restrictions and seller does not have economic benefits in funds until they are released; in most transaction cases, escrowed amounts will not be considered received by seller until circumstances occur requiring release from escrow; CPA may be asked to advise regarding whether seller rights under agreement are appropriately limited at closing; CPA, unless facts suggest otherwise, usually assumes all escrow funds will be received in doing tax calculations in "walk away money" spreadsheet

31

Definitive Agreement - Contingent Payment Arrangements

- Earn outs are part of a minority of deals; when present, they take a variety of forms, most of which are measured with respect to revenue or earnings metrics, but there are occasionally other types of contingent payment arrangement benchmarks; as to former, sellers generally like measurement metric to be as far up the income statement as possible, and buyers may generally like the metric farther down, such as measured after certain expenses or costs; sellers will prefer progressive type arrangements, buyer often cliff type arrangements
- CPA should be prepared to advise regarding rules governing taxation of deals with contingent payment arrangements; see, e.g., Regulation 15a.453-1(c); installment sale rules for determining amount of gain to recognize each year distinguish contingent payment sales for which a maximum selling price is determinable, sales for which a maximum selling price is not determinable but the time over which payments will be received is determinable, and sales for which neither a maximum selling price nor a definite payment term is determinable
- If the entity is a corporation, is to be liquidated after closing and will be distributing an installment obligation received in the deal, will likely be important to adopt a plan of liquidation (12 month) on or before the day of closing; see Sections 453(h) and 453B(h)

32

Definitive Agreement – Gross Up - 1

- If asset sale for tax purposes and there is to be gross up:
  - Review gross up text; "with and without" asset sale text is typical; but other text sometimes used; text should effectively compare net cash owners would have received if transaction treated as a stock deal to net cash owners would receive from treatment as asset deal; calculation should take effect of liquidation or deemed liquidation of seller entities into account, but sometimes parties will agree to a less precise approach
  - Gross up provision may not be well understood by nontax drafter and parties, and general text may produce ambiguity (see discussion earlier slide); so, recommend including exhibit illustrating calculation in definitive agreement; this benefits both seller and buyer as if detailed will show expectations of parties regarding text used in document; CPA should prepare it
  - Seller side – important - seek payment of estimated gross up amount at closing; this is very often overlooked, but can have beneficial effect of not only getting cash to seller earlier, but also for both sides as shows expectations of the parties regarding text in the document

33

Definitive Agreement – Gross Up - 2

- If asset sale for tax purposes and there is to be gross up – continued
  - Parties occasionally agree to a set dollar modification to purchase price intended to approximate gross up, with then no later text about it or later true up
  - More common approach is not to so agree on a set dollar amount, and to finalize determination within some period after closing, often the same or similar to period for finalizing working capital adjustment
  - Party who is to do first post closing calculation of gross up is negotiable, but most often will be buyer; dispute resolution text should included/reviewed, both as to who is to resolve seller-buyer differences in calculation and scope of that person's authority; again, recommended that calculation exhibit be included in agreement
  - Additional negotiated item – whether gross up is to be redetermined in event of examination adjustment to purchase price allocation; seller side typically wants, buyer side often not

34

Definitive Agreement – Allocation - 1

- Allocation provisions should be negotiated as early as possible in any straight asset sale deal or any deal involving sale of disregarded or pass through entity interests or any deal involving deemed asset sale treatment, particularly, as to seller side, if no complete gross up is to be part of deal; the more uncertain the ultimate allocation, the greater the potential seller side desire for gross up; some deal participants may require post closing allocation based on valuation occurring then, but even if so, stating of allocation principles early preferred; best not to defer to near closing
- Obvious influence in many transactions on amount sellers will ultimately receive from deal
- If allocation is to be done post-closing, allocation principles should be included in definitive agreement that are as detailed as possible

35

Definitive Agreement – Allocation - 2

- Allocation at entity level and asset level should be done if more than one seller entity; buyer side may sometimes be indifferent regarding entity level allocations
- Definitive agreement should require all parties to report the transaction in a manner consistent will the final allocation, and prohibit parties from advancing positions inconsistent with allocation on audit
- Agreement may provide that parties will exchange copies of applicable asset acquisition forms at the time of the filing of their respective tax returns

36

Definitive Agreement -Tax Representations and Warranties - 1

- Certain are typical – nonexclusive list of examples below
- Will differ some depending on whether entity purchase or asset purchase deal
- Nature of seller entity – C corp, S corp or tax partnership
- If an S corp:
  - Proper election made
  - Date
  - Federal and state
  - No circumstances at any time resulting in termination of S status
  - Each shareholder and former shareholder was eligible S shareholder
  - No challenge at any time received to S status
  - No liabilities under Section 1374 or 1375

37

Tax Representations and Warranties - 2

- Tax returns and payments
  - All filed; all timely filed
  - Including affiliated groups of which target is or was member
  - No inclusion in such groups currently or previously
  - All are true, accurate and complete
  - No extensions
  - Copies have been provided to buyer
  - All taxes (whether required to be shown on returns or not) have been fully and timely paid
  - No notice from any jurisdiction in which entity does not file that tax return or tax payment may be required

38

Tax Representations and Warranties - 3

- No tax liens on equity interests or assets
- Tax audits/proceedings
  - None pending
  - None threatened
  - No waivers of statutes of limitation or extensions regarding assessment or deficiency
  - Copies of all examination notices, notices of deficiency, etc. have been provided to buyer
- All required withholding done and timely paid – ees, independent contractors, third parties, etc.
- Seller is not a beneficiary of any tax rebate, tax holiday or similar benefit from any government authority

39

Tax Representations and Warranties - 4

- No responsibility for tax liabilities of another
  - Under Section 1502 regulations
  - By reason of tax sharing agreements
  - Under contract
  - As transferee or successor
  - Any other reason
- No closing agreements, offers in compromise existing

40

Tax Representations and Warranties - 5

- No potential for post-closing inclusion of income or prohibition on deduction due to pre-closing matters; e.g.:
  - Use of installment method
  - Accounting method changes
  - Use of improper accounting methods
  - Prepaid amounts received
  - Section 108(i)
  - Related party or intercompany transactions
  - Other
- If corp, it has not distributed stock or had its stock distributed in 355 type transaction

41

Tax Representations and Warranties - 6

- Seller has not be party to any "reportable transaction"
- All transactions that could give rise to an underpayment of tax were reported in a manner that will not give rise to penalties
- Seller has not deferred any taxes or taken a credit for any taxes pursuant to any government program (e.g., COVID-19 related program)
- Seller does not have and has not previously had any foreign establishment and is not liable for any foreign tax or filing obligations
- If an F reorg deal, that all restructuring steps have been completed prior to closing; buyer may want assurance restructuring steps have certain effect; seller side will typically want buyer side to review documents to be filed and make its own assessment regarding same

42

Definitive Agreement - Tax Covenants - 1

- CPA should review all these provisions (sometimes request overlooked)
- Preparation and filing of tax returns
  - In "straight" asset deal, less text
  - In equity purchase, including equity purchases that are deemed asset sale deals, text regarding authority/responsibility to prepare returns needed
  - Seller will typically be responsible for all seller entity returns due prior to closing date; buyer may seek text allowing it to prepare all purchased entity returns due after closing; while may be acceptable, seller usually seeks to carve out from that provision authority to prepare income tax returns for tax periods ending on or before closing date, and in particular income tax return for the "S short year" resulting from termination of S status, which commonly results from such transactions

43

Definitive Agreement - Tax Covenants - 2

- Preparation and filing of tax returns - continued
  - Straddle periods are those that begin before closing and end after; buyer typically prepares; both parties typically desire "closing of the books" text to govern allocation of items to pre- and post-closing times for purposes of allocating responsibility for tax for straddle period income tax returns; similarly, parties typically prefer such text for purposes of allocating items to short S year and short C year returns in cases in which transaction terminates S status; for other than income tax straddle returns (e.g., ad valorem taxes), responsibility for tax is typically allocated between buyer and seller based on daily proration
  - Parties should both have reasonable review and comment rights regarding returns prepared by the other, and dispute resolution provisions are often included
  - Seller will want text stating returns for which seller may have liability for all or portion of tax are to be prepared consistent with prior practices, consistently applied, and that deductions for transaction expenses and change of control and similar payments for which it bears burden are to be for its benefit

44

Definitive Agreement - Tax Covenants - 3

- Seller should seek text prohibiting buyer from amending prior year returns without seller consent, or, if that not acceptable to buyer, then consent required if the amendment would have the effect of increasing seller responsibility for taxes
- Both parties will typically want tax cooperation text relating to such matters as providing access to records and documents in connection with preparation of tax returns and audit proceedings for which it is responsible; seller will usually no longer possess business records after closing and so should seek text requiring buyer to retain them until expiration of statute of limitations period
- Regarding audits, seller should seek text requiring notice of commencement affecting pre-closing periods, and right to control such audits; buyer will want right to participate at its cost; regardless of which party will control, both parties will want right to reasonably approve settlements to be made by the controlling party and right to be kept reasonably informed of progress of audit
- Parties sometimes seek confirming text that no 336 or 338 elections will be made, if that is the case

45

Definitive Agreement - Tax Indemnity

- Typical indemnification in favor of buyer: taxes for tax periods ending on or before closing date; taxes for portion of straddle periods through closing date (seller preference, though, is sometimes to measure with respect to an effective time on closing date); taxes for any group of which any seller entity was a member; and taxes for which any seller entity is liable under contract or as transferee or successor or under law
- CPA should review text, with particular attention to effect of tax provisions governing when tax years end
- Text often states seller indemnification obligation will not expire until some number of days after all applicable statutes of limitation expire

46

Transfer Tax

- Transfer tax on transaction events most often a seller responsibility, sometimes split between parties, rarely buyer complete responsibility – but, is negotiated item, and agreement may depend on magnitude/applicable state/item giving rise to potential transfer tax
- CPA should review definition in definitive agreement
- CPA should assist in evaluating potential amount due and potential exemptions, such as occasional sales exemption
- Obtaining of applicable sales tax exemption certificates from buyer may be helpful for seller in some situations; for example, seller will sometimes seek resale exemption certificate
- If large real estate value, parties sometimes discuss structuring that appropriately eliminates real estate transfer tax

47

Rollovers

- Seller owners sometimes acquire some equity in buyer or buyer affiliate in connection with the business sale; sellers typically want to do so on a tax deferred basis, and buyers are usually eager to cooperate as it is an inducement to seller making investment
- In such cases, CPA should assist in evaluating recommended structure for accomplishing nonrecognition treatment, which will often involve application of Section 721 and sometimes Section 351, and consult with counsel regarding satisfying of requirements of those sections
- Seller side CPA should also be asked to review tax provisions of governing instruments of buyer entity in which seller owners will hold interests, such as operating agreement of buyer LLC if to be taxed as partnership, regarding which CPA will want to advise regarding allocation, distribution, capital account and, importantly, Section 704(c) matters

48

Post Closing Matters - 1

- CPA will naturally (should) participate in post-closing tax-related matters
- Including:
  - Review of any post-closing purchase price allocation proposal; seller side - updating of "walk away money" projection in light of allocation and finalizing of closing statement and working capital
  - Preparation or review of proposed/final gross up calculation
  - Review and comment regarding all pre- and post-closing returns, particularly straddle period returns
  - Preparation or review and exchange of Forms 8594 with other side

49

Post Closing Matters - 2

- It may be advantageous to be sure seller entities engaged in asset sale type transactions are liquidated before the end of the tax year of the owners with or within which the year of the applicable entity ends; this will be particularly important if a liquidation will result in a capital loss to the owner and capital gain/1231 income is being recognized and passed through in the sale transaction; examples of situations in which need to timely liquidate likely are S corporation asset sales where there have been prior outside basis step ups due to prior purchases of stock by current shareholder(s) or receipt of stock by current shareholder(s) upon death
- Can result in need for prompt post-closing work in connection with transactions closing near year end

50

Post Closing Matters - 3

- "Walk away money" seller side spreadsheet should disclose whether prompt liquidation desirable
- Liquidation is automatically deemed to occur in the case of a Section 338(h)(10) election, but that is not be the case (for Holdco) in the case of an F reorganization type transaction

51

Questions/Comments

Thank you for your attention

52

1 p.m. – 2 p.m.

Family Offices
Large, Medium & Small

Lucien Beaudry, J.D., *Shareholder, Reinhart Boerner Van Deuren s.c.*

Gregory Monday, J.D., *Shareholder, Reinhart Boerner Van Deuren s.c.*

WISCONSIN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

TAX CONFERENCE 2022

FAMILY OFFICES: LARGE, MEDIUM & SMALL

Presented by:
Lucien Beaudry
Gregory Monday
Kristi Allen

Introduction

<u>Objective</u>

Help families use a Single Family Office or similar alternative to collectively manage their wealth and financial affairs in a way that is likely to produce better results than if family members are left to find their own ad hoc and separate approaches to investing, financial planning, accounting, and wealth succession.

Introduction

- PART I

  What does a Single Family Office do and how does it benefit the family members it serves?

- PART II

  How can a classic Single Family Office be organized and operated to utilize tax efficiencies that are not available without the Family Office structure?

- PART III

  What are the alternatives for a collective approach to managing the wealth and financial affairs of a family whose net worth cannot support a classic Single Family Office?

What is a "Single Family Office"?

- "Family Office" is a loosely-defined term to refer to any formal structure under which the delivery of a range of financial services is coordinated for all or some of the members of a family and the trusts that have been established for them.
- A Single Family Office entity is established as an LLC or a corporation to provide financial services to family members and their trusts more effectively than an approach under which family members and their trustees obtain financial services from disparate providers on an *ad hoc* basis.

Why a Family Office?

- For family members and their trusts, a collective approach to financial services lowers costs and improves quality of services (through improving quality of service provider and better coordination of services).
- If the family owns an operating business, a formal separation of personal and trust financial management into a segregated, independent entity, lowers the risk that the family business personnel will make mistakes involving personal family and trust affairs due to an uncoordinated, *ad hoc* approach, and reduces the distraction that can be created when family and trust affairs are run through the Business systems.

What Services can a Family Office provide?

- Financial record keeping (electronic and/or hard copies), including:
  - All business entities' governing documents and owner agreements (e.g., shareholders' agreements, operating agreements, voting trusts);
  - Historical business financial reports and account investment statements;
  - Copies of business entity tax returns, trust tax returns, personal income tax returns, gift tax and estate tax returns;
  - Trust instruments, trust amendments, copies of annual accountings, copies of historical investments statements, copies of appointment and resignation of trustees;

What Services can a Family Office provide?

- Financial record keeping (continued):
  - Personal estate planning documents, including prenuptial agreements and powers of attorney;
  - Family member names and contact information, social security numbers, family tree, birthdates and death dates;
  - Copies of documents for substantial personal or trust transactions (e.g., acquisition of a residence, loans among family members or from commercial lenders, purchase or sale of business entity interests, divorce docs, adoption docs);

What Services can a Family Office provide?

- Tax support and compliance, through one third party provider (i.e., YOU!);
- Trust accounting and administration, including payment of life insurance premiums, payment on installment notes, delivery of annual "Crummey" notices, payment of annual amounts under grantor retained annuity trusts, charitable remainder trusts, charitable lead trusts;
- Record keeping and support for 529 Plans;

What Services can a Family Office provide?

- Cash management and bill pay for individuals and trusts;
- Facilitation of individual estate planning through preferred providers, or support provided to personal estate planning professionals, including prenuptial agreements, generation-skipping trusts, and valuation of business entity interests for estate planning transactions;
- Assistance with life insurance, disability insurance, and long-term care insurance underwriting and policy maintenance;

What Services can a Family Office provide?

- Administrative support and record keeping for family foundations and other charitable entities, including coordination of asset custody and management;
- Collaborative or pooled investment in marketable securities for family members and trusts, including negotiated custodial arrangements, with preferred providers;
- Collaborative or pooled investment in alternative investments, including legal review of investment documents, for family members and trusts;

What Services can a Family Office provide?

- Creation and management of family investment vehicles, including LLCs or limited partnerships to make direct investments in promising businesses started by individual family members or third parties;
- Creation and management of a "family bank" to make low interest loans to family members for home acquisitions, education, or new business opportunities.

Summary of Lender Management Case and Sample Family Office Structure

48167978v1

Background

- Goal: operate a family office tax efficiently:
  - Deduct applicable expenses of employees
  - Avoid personal expense characterization
  - Avoid related income and expenses that do not offset
- Challenges:
  - 2017 TCJA – eliminates section 212 deductions, including "investment advisory" deductions
  - "Trade or business" expenses under section 162 are deductible
  - Can a family office be a trade or business? Facts and circumstances test = risk
- 2017 case (Lender Management) provides potential pathway to creating a family office that constitutes a trade or business

Lender Management, LLC v. Commissioner, TC Memo 2017-246

Facts:

- Family office LLC is managed and owned almost entirely by a grandson of a founder of Lender Bagels provided financial advisory and management services to investment LLCs
- Investment LLCs primarily benefited of related younger generation
- Grandson: qualified financial background and served as chief investment advisor
- Family office LLC held a "profits interest" in investment LLCs
- In profitable years, the family office received a distribution and in unprofitable years it did not

Lender Management, LLC v. Commissioner, TC Memo 2017-246

- Key Issue: Did the Family office LLC constitute a "trade or business" for purposes of section 162.
- Key facts in court's finding of a trade or business:
  - Extensive activities of full-time employees
  - Grandson's extensive activities in researching investment opportunities, negotiating and executing new investments, monitoring existing positions, and working with individual clients to understand their investment needs
  - Although heightened scrutiny due to related party status of "clients," taxpayer overcame this scrutiny because of the professional manner of doing business and the family office's observance of formalities
  - Each family member was provided with individually tailored advice based on such family member's situation

15

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Key Considerations For Deductible Expenses

- Actual business activity, conducted on a regular and arms-length basis consistent with a profit motive, and not primarily for the management of one's own capital
- Diverse investment activities (*i.e.*, real estate, private equity, venture capital) could enhance trade or business facts
- Avoid/minimize "personal expenses" at family office
- "Profits interest" is key, although it comes with cash flow risk. Fee from related investment partnership will be non-deductible to the investment partnership.
- Outside clients could be very helpful (especially if services provided on the same terms as related clients). However, this could create a risk of SEC "investment advisor" compliance and registration.

16

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Sample Structure

- Multiple Activities
  - Liquid investments
  - Private Equity/Venture Capital Investments
  - Real Estate
  - Business Consulting
- S corp structure for service entity
- All entities operated in a flow-through structure

17

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Family Office, Inc.

- Taxed as an "S" corporation
- Purpose
  - Investment Management Company
  - Business consulting
- Ownership Structure
  - Owned 100% by Patriarch
- Other
  - Cash flow derived from:
    - Profits interests in managed entities
    - Revenue from consulting and management services
    - Revenue from back office services (*e.g.*, accounting and bill pay)
  - Patriarch may be required to make a capital contribution to fund operations if insufficient cash flow is derived from the profits interests and activities described above

18

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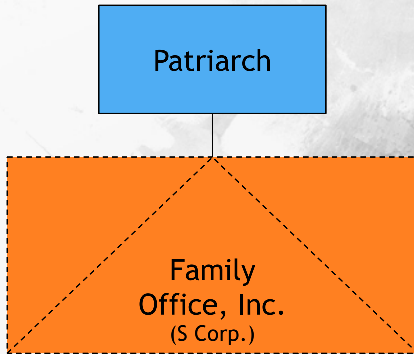
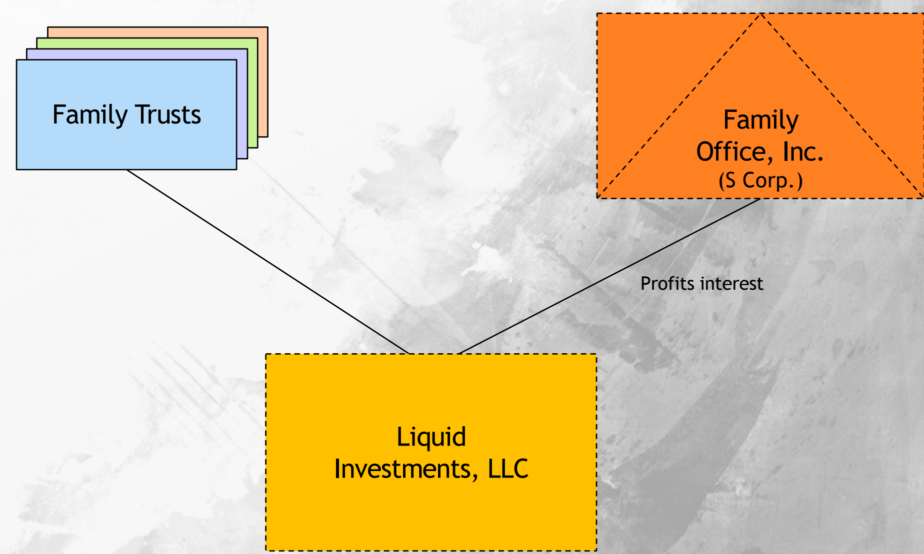


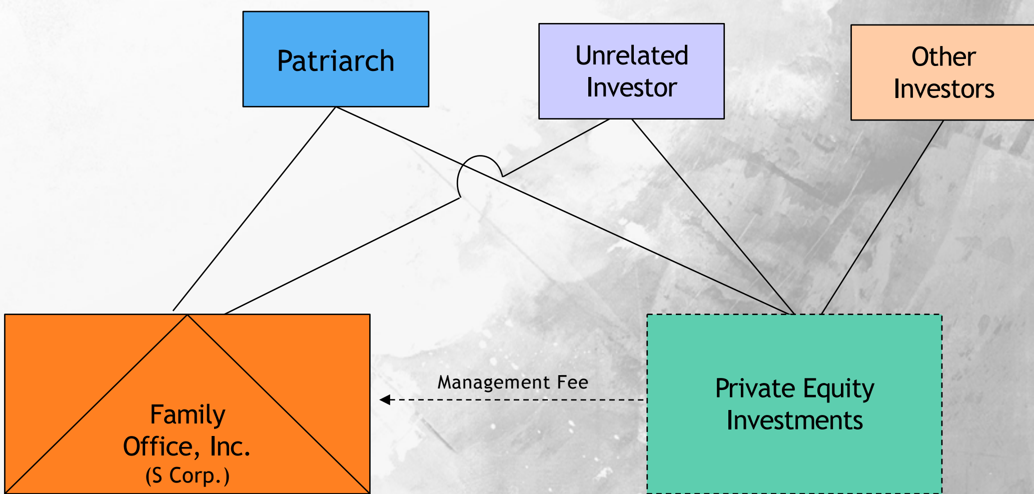
Liquid Investments, LLC

- Purpose
  - Hold liquid investment assets that are capable of being "marked to market" on a monthly basis
  - Intended to qualify as a "securities partnership" for tax purposes
- Ownership Structure
  - Partnership for tax purposes
  - Owned by Patriarch individually, Family Trusts and Family Office, Inc.
  - Patriarch and trusts own "common units"
  - Family Office, Inc. owns "incentive units"
  - Family Office, Inc. is the manager of the LLC
- Other
  - Permits the creation of different investment pools whereby the owners may have a different percentage in the various pools. May also operate using just one pool to ease the accounting burden.
  - Incentive Units entitle Family Office, Inc. to a portion of the profits of Liquid Investments, LLC, determined separately for each pool. Each owner (including Family Office, Inc.) controls the timing of distributions of its share of capital contributions and profits, and may cause distributions to be made on a periodic basis to the extent such owner has a positive capital account
  - Accrued allocations to Family Office, Inc. carryover and are paid when the company has sufficient cash flow



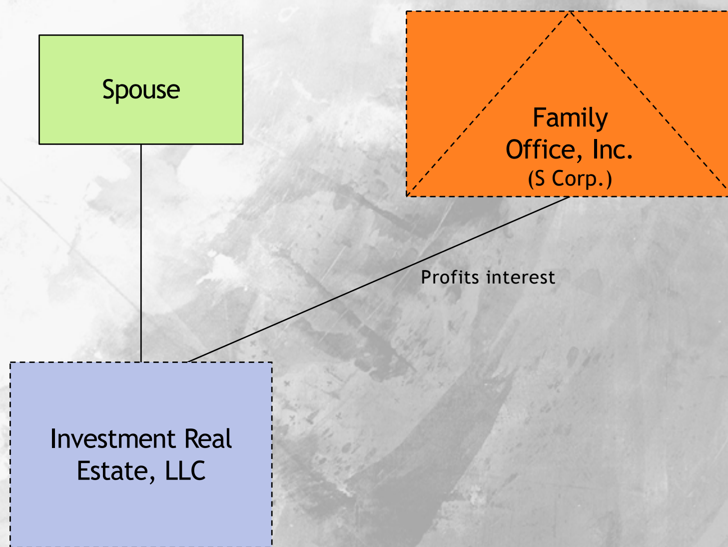
Private Equity Investments

- Purpose
  - Invest in the equity of closely held businesses (the "Private Equity Investments")
  - Provide management services to the Private Equity Investments through Family Office, Inc.
- Ownership Structure
  - The Private Equity Investments are owned by Patriarch, Unrelated Investor and certain other investors and key employees
- Other
  - Family Office, Inc. receives a management fee from each of the Private Equity Investments



Investment Real Estate, LLC

- Purpose
  - Invest in long-term hold real estate
- Ownership Structure
  - Partnership for tax purposes
  - Spouse owns 100% of common units, and Family Office, Inc. owns "Incentive Units"
  - Family Office, Inc. and Spouse are the managers of the LLC, and Spouse's decision would control in the event of a disagreement between Family Office, Inc. and Spouse
- Other
  - Incentive Units entitle Family Office, Inc. to a portion of the profits of Investment Real Estate, LLC.
  - The manager controls the timing of distributions of the profits, and may cause distributions to be made on a periodic basis
  - Accrued allocations to Family Office, Inc. carryover and are paid when the company has sufficient cash flow
  - All other profits are allocable to Spouse, and other cash flow is distributable to Spouse

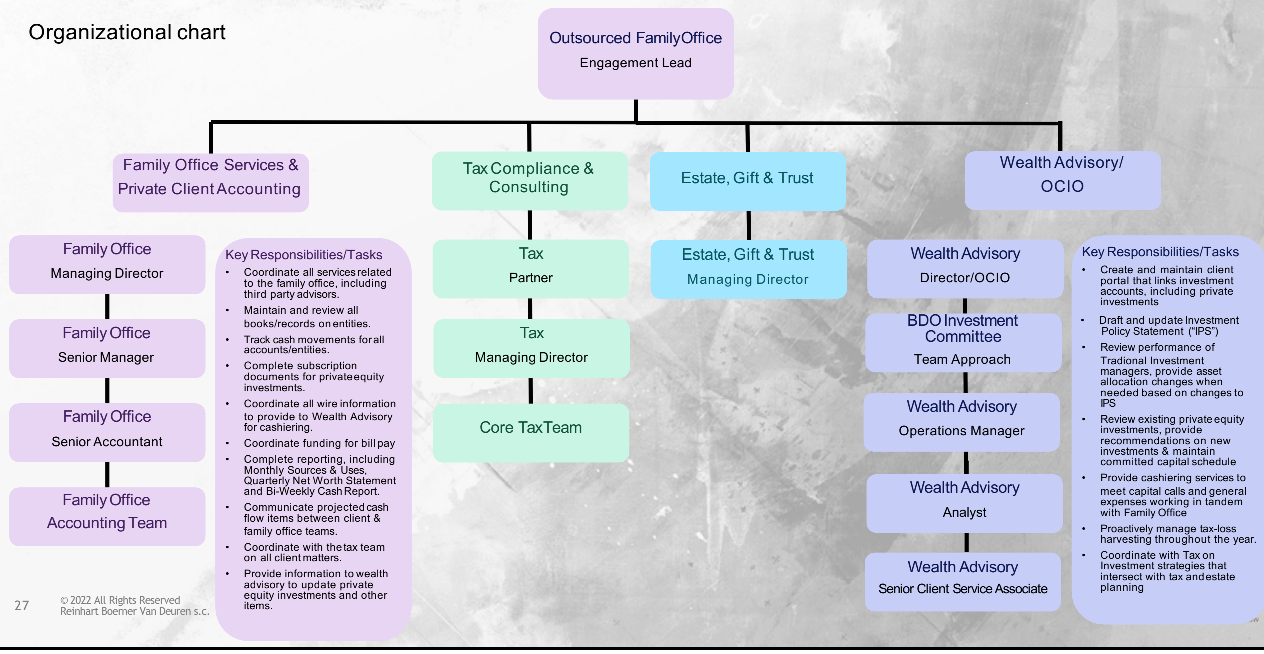


Alternatives to "Lender"-style Single Family Office

- Fee-Based Single Family Office (i.e., break-even model; no carried interest).
- Multi-Family Office: a third party financial services firm provides all the infrastructure and back office functions.
- Virtual Family Office or Out-Sourced Family Office: a team of third party service providers, coordinated by one or more designated family members.
- Collective investing: Example, Family Limited Partnership.

Outsourced Family Office Services

Organizational chart



Thank you for attending!

Questions?

Reinhart
Boerner Van Deuren s.c. Attorneys at Law

1 p.m. – 2 p.m.

Schedules K-2 & K-3: What Taxpayers Need to Know

Heidi Konkel, CPA, *Senior Manager, Wipfli LLP*

Schedule K-2 & K-3 – What Taxpayers Need to Know

Heidi Konkel
- Director of International Tax

WIPFLI

AGENDA

01 BACKGROUND

02 WHO NEEDS TO FILE SCHEDULES K-2 & K-3?

03 PARTS TO SCHEDULES K-2 & K-3

04 FILING PENALTIES

05 FREQUENTLY ASKED QUESTIONS

06 OPEN ITEMS/ISSUES

07 KEYS AREAS TO NOTE 2022

08 CONCLUSION

BACKGROUND

BACKGROUND

Background

- Intended to assist partners and shareholders in preparing their own tax filings regarding foreign matters.
- Create consistency amongst tax practitioners
- Schedule K-2 is an extension of Schedule K
- Schedule K-3 is an extension of Schedule K-1
- IRS Notice 2021-39 provided relief
- January 18, 2022, revised instructions
- Required for all passthrough entities 2021 tax year
- February 16, 2022, IRS provided relief for 2021 filings

02

WHO NEEDS TO FILE SCHEDULES K-2 & K-3

WHO NEEDS TO FILE SCHEDULES K-2 & K-3

Taxpayers with a tax year beginning on or after January 1, 2021.

- Domestic partnerships
- S Corporations
- Foreign partnerships
  - Category 1 – Persons that control 50% or more of the foreign partnership
  - Category 2 – Taxpayers that own 10% or more if there is no Category 1 filer.

Exception for Short Period Returns - 2021 Tax Year

Exceptions added February 16, 2022 – 2021 Tax Year if taxpayer meets all the following:

- No foreign partners
- No foreign activity
- 2020 filing did not include information on Schedule K line 16 and 20c for 1065 and lines 14 and 17d for S Corporations **AND**
- Entity has no knowledge that the owners are requesting such information for tax year 2021.

https://www.irs.gov/businesses/partnerships/frequently-asked-questions-Frequently ASKED QUESTIONSs-for-2021-short-tax-year-pass-through-entity-returns-and-schedules-k-2-and-k-3

WHO NEEDS TO FILE SCHEDULES K-2 & K-3

- 2022 Tax Year – Required for All?
- August 31, 2022, AICPA letter to Office of Associate Chief Counsel
  - Provide broader exceptions
  - Provide permanent exceptions from filing as already provided in IRS Frequently Asked Questions for 2021 filing season
  - Consolidated Form 8082 filings
  - Simplification of Foreign Tax Credit Reporting

https://www.taxnotes.com/research/federal/other-documents/irs-tax-correspondence/aicpa-maintains-focus-on-schedules-k-2%2c-k-3-compliance/7f1td

03

PARTS TO SCHEDULES K-2 & K-3

PARTS TO SCHEDULES K-2 & K-3

Form - 1065

- Part I – Attachments
- Part II - Foreign Tax Credit Limitation
- Part III – Information to prepare Form 1116 or 1118
  - Gross Receipts by SIC code
  - Interest Expense Apportionment Factors
  - Foreign Derived Intangible Income (FDII) Deduction Apportionment Factors
  - Foreign Taxes
  - Other tax information - §743(b) adjustments
- Part IV- IRC Section 250 Deduction related to FDII
- Part V – Distributions from Foreign Corporations to Partnership
- Part VI – Partners' IRC Section 951(a) and IRC Section 951A Inclusions
- Part VII – Information to Complete Form 8621
- Part VIII – Partnership Interest in Foreign Corporation Income (IRC Section 960)
- Part IX – Base Erosion and Anti-Abuse Tax (BEAT) IRC Section 59A
- Part X – Foreign Partner Character and Source of Income
- Part XI – IRC Section 871(m) Covered Partnerships
- Part XII – Reserved for Future Use
- Part XIII – Foreign Partner's Distributive Share of Deemed Sale Items or Transfer of Partnership Interest*

PARTS TO SCHEDULES K-2 & K-3

Form – 1120S

- Part I – Attachments
- Part II - Foreign Tax Credit Limitation
- Part III – Information to prepare Form 1116
  - Gross Receipts by SIC code
  - Interest Expense Apportionment Factors
  - Foreign Taxes
- Part IV – Distributions from Foreign Corporations to Corporation
- Part V – Shareholders' IRC Section 951(a) and IRC Section 951A Inclusions
- Part VI – Information to Complete Form 8621
- Part VII – Corporation's Interest in Foreign Corporation Income (IRC Section 960)

PARTS TO SCHEDULES K-2 & K-3

Form- 8865

- Part I – Attachments
- Part II – Foreign Tax Credit Limitation
- Part III – Information to prepare Form 1116 or 1118
  - Gross Receipts by SIC code
  - Interest Expense Apportionment Factors
  - Foreign Derived Intangible Income (FDII) Deduction Apportionment Factors
  - Foreign Taxes
  - Other tax information - §743(b) adjustments
- Part IV – IRC Section 250 Deduction related to FDII
- Part V – Distributions from Foreign Corporations to Partnership
- Part VI – Partners' IRC Section 951(a) and IRC Section 951A Inclusions
- Part VII – Information to Complete Form 8621
- Part VIII – Base Erosion and Anti-Abuse Tax (BEAT) IRC Section 59A

04

FILING PENALTIES

FILING PENALTIES

When Penalties Apply

- Failure to file or show all the information required on schedules IRC Section 6698 & IRC Section 6699
- Failure to file correct information return IRC Section 6721
- Failure to furnish correct payee statements IRC Section 6722
- Failure to file information required by IRC Section 6038

FILING PENALTIES

2021 Filing Instructions

- $280 per owner for incorrect information
  - maximum of $3,426,000 for partnerships
- If intentionally disregarded, penalty is increased to $570, or if greater 10% of the aggregate amount of items to be reported.

FILING PENALTIES

2021 Relief – Notice 2021-39

- Only applies to tax years beginning in 2021
- File 1065, 1120S or 8865 timely
- Good faith effort to comply

05

FREQUENTLY ASKED QUESTIONS

FREQUENTLY ASKED QUESTIONS - IRS

- FAQ #5 - New Information Required
  - No, all the information requested on Schedule K-2 and K-3 was required in the past.
- FAQ #15 - Exceptions
  - Provided the exception list for the 2021 filing season based on 2021 data and the 2020 filing.
- FAQ #18 - Additional Questions or Comments to IRS
  - Additional inquires to the IRS can be made at lbi.passthrough.international.form.changes@irs.gov.
- FAQ #19 - Passthrough doesn't qualify under FAQ#15
  - Only applicable portions of the schedules are required to be filled out
- FAQ #20 - Multiple Filers of Form 5471, 8865 and/or 8858
  - If appropriate disclosures in taxpayer's filing the forms are not required, however, applicable portions of the Schedules K-2 and K-3 are to be filled out.

FREQUENTLY ASKED QUESTIONS - IRS

- FAQ #22 – Reporting for Section 1 of Part III
  - If a taxpayer does not have research and experimental expenses and it is not expected that the owner of the passthrough to license, sell or transfer intangible property to the passthrough.
- FAQ #23 - Mark to Market Election Made on PFIC
  - The filer does not need to report information in Part VII. However additional information may be needed by the ultimate filer if the mark-to-market election was not made in the first year of the holding period.
- FAQ #24 – Reporting Dormant Foreign Corporations
  - Part corresponding with Corporation's Interest in Foreign Corporation Income (IRC Section 960) does not need to be filled out.
- FAQ #26 – Part X, Section 3 Assets & Liabilities
  - Clarification will be added to 2022 filing instructions. For 2021 taxpayers can Treasury Regulation Section 1.882-5 to allocate assets, liabilities and directly allocated partnership indebtedness.

https://www.irs.gov/businesses/schedules-k-2-and-k-3-frequently-asked-questions-forms-1065-1120s-and-8865

FREQUENTLY ASKED QUESTIONS

- When would an individual not be required to file Form 1116 to take a foreign tax credit?
  - When all foreign sourced income is passive and the total amount of creditable foreign taxes are not more than $300 ($600 if married filing joint).
- Why are gross receipts required to be reported?
  - Treasury Regulation Section 1.861-17 requires that research and experimental (R&E) expenses are allocated based on gross receipts. If a taxpayer has R&E the deduction allocable to foreign sources could impact foreign tax credits coming from other sources.
- What are average assets required to be reported?
  - Interest expense is allocated to foreign sources using the greater percentage of foreign gross sales over total gross sales or foreign average assets over total average assets. By not incorporating interest expense in the foreign tax credit calculation, it is possible to overstate foreign sourced income which could lead to an invalid foreign tax credit calculation.

FREQUENTLY ASKED QUESTIONS

- Partnership has sales to foreign countries. What is reported?
  - If not a tiered partnership structure and no C Corporation as a partner no information would need to be reported
  - If tiered structure or a Corporation as a partner information would be included to calculate the foreign derived intangible income (FDII) deduction.
- What if Schedule K-3 was not received with Schedule K-1?
  - Go back to the tax preparer of the passthrough entity and ask for them to provide the Schedule K-3 data, or
  - File Form 8082 and report each instance to indicate the passthrough that didn't provide Schedule K-3
- Passthrough entity receives a K-3 from a partnership. How does this information get incorporated into the taxpayers' Schedule K-2 and Schedule K-3?
  - First the taxpayer would calculate their Schedule K-2 without regard to any factors from the passthrough entity. Then the Schedule K-3 received is layered on top of the taxpayer's information to arrive at the totals to be reported on the taxpayer's Schedule K-2.

FREQUENTLY ASKED QUESTIONS

- What should be filled out for a partnership that has no foreign owners but has a C Corporation partner?
  - If no foreign sales Schedule K-2 Part I, Part II, Part III, Part IV Line 1, Part V, Part VI, Part VII, Part VII and Part IX.
    - If parts Part V, Part VI, Part VII and Part VIII are not applicable to taxpayer those parts do not need to be filled out.
  - If foreign sales, same a above except Part IV should be filled out in its entirety

- What should be filled out for a partnership that is 100% domestic with no direct foreign owners, but the full ownership structure is not known?
  - If the full ownership structure is not known, Part I, Part II, Part III, Part IV and Part IX

06

OPEN ITEMS/ISSUES

OPEN ITEMS/ISSUES

- Tiered Partnerships and timing
- Schedule K-3 for 1065 has a part XIII, but no Schedule K-2 equivalent
- Received K-1 but not K-3
- Form 926 information still requires a footnote disclosure
- IRC Section 951(a) and IRC Section 951A does not include foreign taxes allocable to that income
- Inconsistent information in footnotes
- 2022 passthrough entity would need to document why they are not required to file Schedules.

07

KEYS AREAS TO NOTE FOR 2022

KEYS AREAS TO NOTE FOR 2022

- Review of owners' citizenship
- Type of domestic owners
- Determination of applicable part of Schedules to be filled out
- Review of foreign ownership, foreign subsidiaries, foreign related party transaction for additional reporting requirements

KEYS AREAS TO NOTE FOR 2022

- No penalty relief for tax years beginning on or after January 1, 2022
- Limited exceptions to filing
- Documentation of non-filing
- IRS will be updating instructions and schedules

08

CONCLUSION

CONCLUSION

- Not all information is included in Schedule K-3
- Review IRS Frequently ASKED QUESTIONS
- Review updated filing instructions and forms for 2022 when released

Questions?

Heidi Konkel

Director International Tax

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wipfli.com

2:15 – 3:45 p.m.

The SECURE Act Regulations: IRAs After Death

Robert Keebler, CPA/PFS, MST, AEP, *Partner, Keebler & Associates LLP*

The SECURE Act
Proposed Regulations

Post-mortem IRA Distributions

Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished)

February 28, 2022

Effective Date

- The new proposed regulations apply to distributions on or after January 1, 2022.
- *Recall,* taxpayers were to calculate 2021 distributions by applying the existing regulations and a reasonable, good faith interpretation of the Secure Act

Regulations Table of Contents §1.401(a)(9)-0

Death Before Required Beginning Date §1.401(a)(9)-3

- Key Point
  - Based on the existing regulations

Determination of The Designated Beneficiary §1.401(a)(9)-4

- Key Points
  - Substantially similar to existing regulations
  - Simplifies identifying the beneficiary for §401(a)(9) when the retirement account is payable to a trust
  - Adds examples to clarify common questions involving IRA trusts
  - Expounds on the definition of an eligible designated beneficiary
  - Defines age of majority as the child's 21^{st} birthday to avoid conflict of law complexities
  - Expounds on the definition of disabled
  - Expounds on the definition of chronically ill

Required Minimum Distributions From Defined Contribution Plans §1.401(a)(9)-5

- Key Points
  - Largely retains the pre-existing structure
  - Retains life expectancy distributions for pre-2020 deaths
  - Retains the "ghost life expectancy rule" which applies when there is not a qualified designated beneficiary
  - Modifies the post-mortem distribution calculations to include the new 10-year rule
  - Modifies the multiple beneficiary rules to account for the new 10-year rule

Rollovers and Transfers §1.401(a)(9)-7

- Key Point – Retains the pre-existing rules
- However, the § 402(c) regulations will be updated
  - Rollovers
  - Distributions

Special Rules §1.401(a)(9)-8

- Key Points
  - Separate account treatment
  - Updated definition of spouse
  - Qualified domestic relation order rules
  - Elections

Life Expectancy and Distribution Period Tables §1.401(a)(9)-9

- Key Point: Only includes minor changes to terminology

Other Sections Modified

Distribution Requirements for IRAs §1.408-8

- The IRA distributions regulations will also be updated for the SECURE Act
- A nominal change is made to account for the RBD age increase from 70½ to 72
- However, there are also several other changes to incorporate the Secure Act, including rules regarding surviving spouses

Other Sections Modified

- The proposed regulations also include other small modifications
  - § 1.457-6(d) is modified to strike a reference to age 70½
  - § 54.4974-1 involves the accumulation excise tax and also will be modified to implement the Secure Act; specifically to account for the new 10-year rule

Death Before Required Beginning Date §1.401(a)(9)-3

Death Before RBD

- 5-year Rule – Proposed Regulations
  - Full distribution by the end of the calendar year that includes the fifth anniversary of death (e.g. 2022 deaths = 12/31/27 liquidation)
  - Pre-2020 deaths can disregard the 2020 calendar year when determining the fifth anniversary (due to corona-virus related relief)
  - This rule applies if there's no qualified Designated Beneficiary

Treas. Reg. §§ 1.401(a)(9)-3(c)(2),(5)

Death Before RBD

- 10-year Rule– Proposed Regulations:
  - Full distribution by the end of the calendar year that includes the tenth anniversary of death (e.g. 2021 deaths = 12/31/31 liquidation)
  - This rule applies if there is a qualified Designated Beneficiary who is not an Eligible Designated Beneficiary

Treas. Reg. §§ 1.401(a)(9)-3(c)(3),(5)

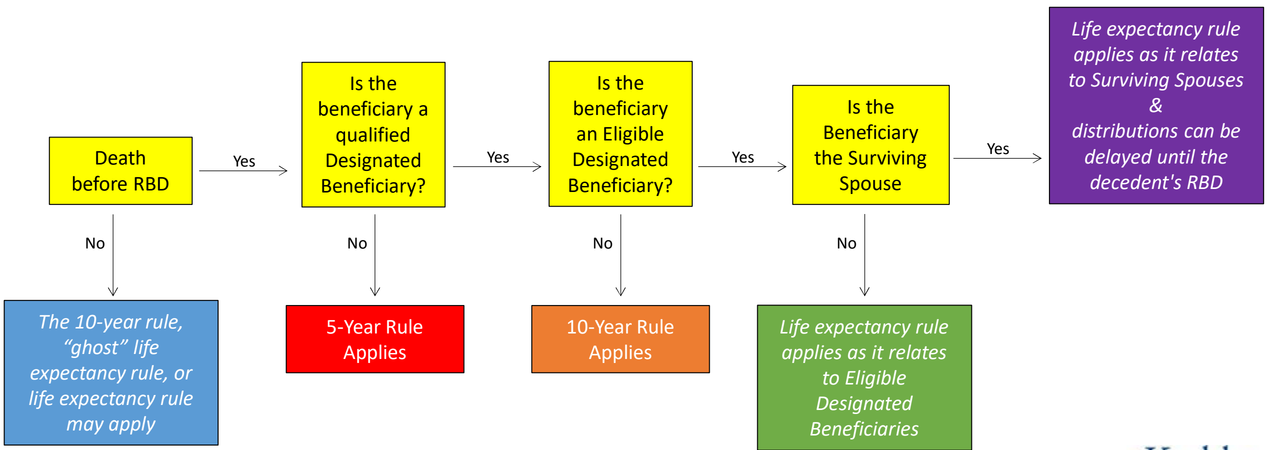
Death Before RBD

- Surviving Spouse as Beneficiary – Proposed Regulations:
  - Commencement of distributions can be delayed under the end of the calendar year in which the decedent would have reached age 72 (Age 70½ applies if the decedent was born before July 1, 1949)
  - If the surviving spouse is the employee's sole beneficiary and dies after the employee, but before distributions commence or should have (due to the above) then the 5-year or 10-year rule applies, as the case may be, and date of death of the surviving spouse is used to determine when the IRA must be fully distributed
  - If the surviving spouse remarries and then dies before receiving distributions, distributions cannot be further delayed

Treas. Reg. §§ 1.401(a)(9)-3(d), (e)

Death Before RBD

§1.401(a)(9)-3 Summary



Determination of The Designated Beneficiary §1.401(a)(9)-4

Determination of The Designated Beneficiary

- General Rules in the Proposed Regulations:
  - A beneficiary need not be specified by name, provided the beneficiary is identifiable – for example: "children in equal shares" is OK
  - A beneficiary can be designated by default election provided by the custodian (plan) agreement or by affirmative election
  - A qualified Designated Beneficiary must be an individual or an individual who is an identifiable beneficiary of a see-through trust; it cannot be an estate for example
  - A named beneficiary can or must be disregarded in certain circumstances

Treas. Reg. §§ 1.401(a)(9)-4(a),(b)

Determination of The Designated Beneficiary

- When can a designated beneficiary be disregarded:
  - A designated beneficiary who executes a qualified disclaimer within 9-months of death can be disregarded
  - A beneficiary who disclaims before Sept 30 of the calendar year following the calendar year of death, but not within 9-months of death, remains a designated beneficiary
  - A beneficiary who receives consideration in exchange for their disclaimer, remains a designated beneficiary
  - A charity named as beneficiary can be disregarded if their interest is satisfied by Sept 30 of the calendar year following the calendar year of death
  - A surviving spouse treated as predeceasing under a simultaneous death provision, can be disregarded as a beneficiary
  - A beneficiary who dies before Sept 30 of the calendar following the calendar year of death, remains a beneficiary absent specific events

Treas. Reg. § 1.401(a)(9)-4(c)

Determination of The Designated Beneficiary

- Application to the Surviving Spouse
  - If the surviving spouse is the employee's sole beneficiary and dies after the employee, but before distributions commence – the successor beneficiary is the person designated as beneficiary as of the date of the surviving spouse's death and remains a beneficiary as of Sept 30 of the calendar year following the calendar year of the surviving spouse's death

Treas. Reg. § 1.401(a)(9)-4(d)

Eligible Designated Beneficiary Defined

- Added by the SECURE Act, IRC § 401(a)(9)(E)(ii) creates a new concept and exception to the 10-year rule, the Eligible designated beneficiary

- This class of beneficiaries includes designated beneficiaries which are:
  - The surviving spouse of the employee
  - A child of the employee who has not yet reached the age of majority
  - Disabled
  - Chronically ill, or
  - not more than 10 years younger than the employee

IRC § 401(a)(9)(E)(ii); Treas. Reg. § 1.401(a)(9)-4(e)(1)

Eligible Designated Beneficiary Defined

- **Multiple Designated Beneficiaries**
  - Generally, if least one of multiple DBs is not an EDB, favorable treatment under the EDB rules is not available
  - However, there are exceptions:
    - For minor children EDBs
    - Applicable multi-beneficiary trusts
    - When separate account treatment is available

Treas. Reg. § 1.401(a)(9)-4(e)(2)

Eligible Designated Beneficiary Defined

- **Special Rule for Children & Multiple Beneficiaries**
  - If any DB is an EDB as a minor child, EDB treatment is available even if other DBs are not EDBs

Treas. Reg. § 1.401(a)(9)-4(e)(2)(ii)

Eligible Designated Beneficiary Defined

- **A child of the employee who has not yet reached the age of majority:**
  - The proposed regulations refine the definition of age of majority; the statute does not provide an age.
  - Specifically, the proposed regulations provide a child meets the age of majority on their 21st birthday. Treasury reasoned setting the age higher, to accommodate the definition in all 50 states would avoid conflict of law issues and simplify custodian agreements.
  - The preamble also restates the statutory allowance that a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26.

Treas. Reg. § 1.401(a)(9)-4(e)(3)

Eligible Designated Beneficiary Defined

- **A child of the employee who has not yet reached the age of majority:**

Recall, the 10-year rule applies once this exception no longer apples.

Special consideration is warranted regarding disposition of assets when the IRA is forced to liquidate between age 31 and 36.

Eligible Designated Beneficiary Defined

- **Disabled:**
  - IRC § 401(a)(9)(E)(ii)(III), as added by the secure act, provides that the definition of disability under IRC § 72(m)(7) applies.
  - IRC § 72(m)(7) determines disability based on whether an individual is unable to engage in substantial gainful activity.
  - The proposed regulations expand this definition to make it easier to apply to those under age 18.

Treas. Reg. § 1.401(a)(9)-4(e)(4)

Eligible Designated Beneficiary Defined

- **Disability Definition – Over 18:**

  "Unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration"

- **Disability Definition – Under 18:**

  "a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or to be of long-continued and indefinite duration"

Treas. Reg. §§ 1.401(a)(9)-4(e)(4)(ii),(iii)

Eligible Designated Beneficiary Defined

- **Social Security Disability Determination:**

  If an individual is determined to be disabled for Social Security with the meaning of 42 U.S.C. 1382c(a)(3) they will be treated as disabled for these rules

- **Disability Documentation Requirements:**

  Documentation must be provided to the plan administrator no later the October 31 of the calendar year following the calendar year of the employee's death.

Treas. Reg. § 1.401(a)(9)-4(e)(4)(iv),(7)

Eligible Designated Beneficiary Defined

- **Chronically Ill:**
  - IRC § 7702B(c)(2) provides the definition of Chronically Ill
  - Documentation requirements in the proposed regulations:
    - A licensed healthcare practitioner's certification is required
    - The certification must include the individual is unable to perform at least two activities of daily living (ADLs) for an indefinite period that is reasonably expected to be lengthy in nature
    - Documentation must be provided to the plan administrator no later the October 31 of the calendar year following the calendar year of the employee's death.

Recall, ADLs include: Mobility, Dressing, Eating, Personal Hygiene, and Toileting

Treas. Reg. §§ 1.401(a)(9)-4(e)(5),(7)

Eligible Designated Beneficiary Defined

- **Beneficiaries who qualify as an Eligible Designated Beneficiary (EBD) *as a minor child and as disabled or chronically ill:***
  - Minor children will continue to be treated as an EBD after reaching the age of majority
  - However, the documentation requirements outlined in the previous slides *must be timely met*

Treas. Reg. § 1.401(a)(9)-4(e)(8)

Eligible Designated Beneficiary Defined

- **Disabled:**

This modification is important as it allows a minor who is also disabled to take life expectancy-based distributions over their entire life span rather than merely while under 21 as a person who has not yet reached the age of majority.

Treas. Reg. § 1.401(a)(9)(E)(ii)(III)

Eligible Designated Beneficiary Defined

- **Disabled:**

The regulations fail to provide relief for a minor beneficiary who becomes disabled before reaching the age of majority.

IRC § 401(a)(9)(E)(ii) requires the disability determination made at the employee's death.

Treas. Reg. § 1.401(a)(9)(E)(ii)(III)

Eligible Designated Beneficiary Defined

- **Examples involving EBDs *as* both a minor child and as disabled or chronically ill:**
  1. Parent dies in 2022 with their child as beneficiary. The child won't reach the age of majority until 2024 and qualifies as disabled. If the documentation requirements are satisfied, life expectancy payments can continue after 2024 rather than the 10-year rule forcing complete distribution by 2034.
  2. Parent dies in 2022 with their child as beneficiary. The child won't reach the age of majority until 2024 and qualifies as disabled. However, the documentation requirement to qualify as disabled is not timely satisfied. Total distribution must occur by 2034.
  3. Parent dies in 2022 with their child as beneficiary. The child won't reach the age of majority until 2024 and becomes disabled in 2023. Because the child was not disabled at the parent's death, they cannot qualify as disabled and therefore total distribution must occur by 2034.

Treas. Reg. §§ 1.401(a)(9)-4(e)(9)

Eligible Designated Beneficiary Defined

- **Individual not more than 10 years younger than the employee.**
  - The proposed regulations clarify how this is measured
  - Specifically, they provide its based on dates of birth
  - The example used is as follows:
    - ➢If the decedent's date of birth is 10/1/1953
    - ➢The youngest possible beneficiary's date of birth is 10/1/1963

Treas. Reg. § 1.401(a)(9)-4(e)(6)

Eligible Designated Beneficiary Defined

- **EDBs as DBs of the Surviving Spouse**
  - If the DB of a Surviving Spouse qualifies as an EDB at the time of the Surviving Spouse's death, EDB treatment is available

Treas. Reg. § 1.401(a)(9)-4(e)(8)

Trusts as Beneficiaries

- The proposed regulations retain:
  - The see-through concept to identify beneficiaries
  - The conduit and accumulation trust concept
  - The four requirements for a trust to be a qualified designated beneficiary
- The proposed regulations also provide additional guidance regarding identifying beneficiaries with new fact pattern examples.

Treas. Reg. § 1.401(a)(9)-4(f)

Trusts as Beneficiaries

- Certain beneficiaries can disregarded – #1: conditioned on the death of secondary beneficiary
  - A beneficiary that could receive retirement assets solely because of the death of another beneficiary can be disregarded
  - Applies to accumulation trusts
  - The current beneficiary cannot pre-decease the IRA owner (plan beneficiary/employee) for the residuary beneficiary to be disregarded
  - Meant to exclude minimal interests

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)

Trusts as Beneficiaries

- See-through trust beneficiaries disregarded – an example:

IRA trust provides: (1) first to surviving spouse, (2) then to brother, if he's alive, at the spouses death, and (3) then to charity.

In this case, the brother is only entitled to a residual interest and the charity is entitled to only what remains thereafter – so the charity can be disregarded.

Pg. 32

The charity would be counted if the brother's interest was not subject to any contingences or contingent on an event other than the surviving spouse's death.

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)

Trusts as Beneficiaries

- Certain see-through trust beneficiaries disregarded - #2: entitlement conditioned on death of young individual
  - If a trust provides for full distribution by the calendar year following the death, any beneficiary whose sole entitlement is contingent on the primary beneficiary's death can be disregarded.
  - If a trust provides for a minor beneficiary, any beneficiary whose sole entitlement is contingent on the primary beneficiary's death within 10-years of reaching the age of majority can also be disregarded
  - Meant to exclude remote interests

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B)

Trusts as Beneficiaries

- See-through trust beneficiaries disregarded – an example:
  - You have a 45 year old physician client, recently divorced, who dies in a car accident
  - He had accumulated about $500,000 in his qualified plan (diligent contributions since residency) so you advised a testamentary stand-alone IRA trust in his estate plan.
  - He leaves behind a 15 and 13 year old who are beneficiaries of trust
  - Since he had no one else, his 72 year-old father is the contingent beneficiary, in case both children are unavailable, and thereafter the trust is payable to his alma mater

IRA → See-Through Trust Named as IRA Beneficiary → Children

Father/University, contingent on beneficiary deaths

Disregarded for Identification

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B)

Trusts as Beneficiaries

- Conduit trusts allowed terms for certain accumulations
  - A trust will not fail to be treated as a conduit trust merely because the trust terms requiring the direct payment of amounts received from the plan do not apply after the death of all of the current beneficiaries

IRA → Conduit Trust → Current Beneficiary

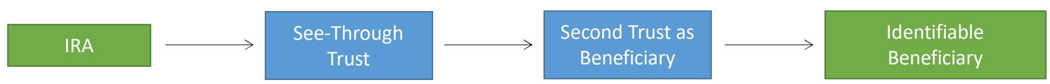
Successor beneficiary upon death of current beneficiary

Disregarded for Conduit Trust Treatment

Treas. Reg. § 1.401(a)(9)-4(f)(3)(iii)

Trusts as Beneficiaries

- Multiple Trust Arrangements
  - If a beneficiary of a see-through trust is another trust, the beneficiaries of the second trust will be treated as beneficiaries of the first trust, provided the second trust is a Qualified Designated Beneficiary



Treas. Reg. § 1.401(a)(9)-4(f)(4)

Trusts as Beneficiaries

- Identifiability of trust beneficiaries
  - Generally, it must be possible to identify each person designated by the employee to receive retirement plan assets
  - However, the proposed regulations provide some relief:
    - An employee can name a class of individuals as the beneficiary
    - And now the addition of another member of that class will not fail the identifiability requirements
    - For example, grandchildren can be named as a class and the birth of another grandchild will not pose a problem

Treas. Reg. § 1.401(a)(9)-4(f)(5)

Trusts as Beneficiaries

- Powers of Appointment
  - Generally, if an individual holds a power of appointment over the retirement assets it creates an identifiability problem.
  - However, the proposed regulations provide relief:
    - ➢Power to name a non-identifiable beneficiary doesn't cause the trust to fail the Qualified Designated Beneficiary (QDB) requirements
    - ➢If the power is exercised by Sept. 30 in the calendar year following the calendar year of death the appointed beneficiaries are DBs
    - ➢The power can also be restricted by Sept. 30 to a group of beneficiaries which will then be treated as DBs.
    - ➢If the power is not exercised (or restricted) by that Sept, 30 then the taker in default is treated as the DB.

Treas. Reg. § 1.401(a)(9)-4(f)(5)(ii)(A)

Trusts as Beneficiaries

- Powers of Appointment
  - If a POA adds a new beneficiary after Sept. 30 of the calendar year following the calendar year of death that the added beneficiary is considered a DB
  - If the added beneficiary requires a full distribution, the distribution must occur by the end of the calendar year following the calendar year in which the beneficiary was added

Treas. Reg. § 1.401(a)(9)-4(f)(5)(ii)(B)

Trusts as Beneficiaries

- Reformation & Decanting
  - The proposed regulations provide that a see-through trust will not fail to satisfy the identifiability requirements if state law permits the trust to be modified after death (and the terms are modified after the death to a change beneficiaries).
  - If a beneficiary is removed by Sept 30 of the calendar year following the calendar year of the employee's death, the beneficiary is simply disregarded.
  - A beneficiary added by that Sept 30 will also be considered a beneficiary for the see-through rules.

Treas. Reg. § 1.401(a)(9)-4(f)(5)(iii)(A)

Trusts as Beneficiaries

- Reformation & Decanting
  - The proposed regulations provide that a see-through trust will not fail to satisfy the identifiability requirements if state law permits the trust to be modified after death and terms are modified after the death

Treas. Reg. § 1.401(a)(9)-4(f)(5)(iii)(A)

Trusts as Beneficiaries

- Reformation & Decanting
  - **Remove Beneficiary:** A beneficiary cannot be removed the after Sept 30 of the calendar year of the calendar year following death
  - **Add Beneficiary:**
    - ➢A beneficiary added before Sept 30 of the calendar year of the calendar year following death is considered a DB
    - ➢A beneficiary is added after the Sept 30 deadline is analyzed under the new POA rules
      - ✓Will not cause the trust to fail the identifiability rules
      - ✓The added beneficiary will be considered in determining the proper distribution in the calendar year after the calendar year of addition (including an addition which requires full distribution)

Treas. Reg. §§ 1.401(a)(9)-4(f)(5)(iii)(B),(iii)(C),(iv)

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Trusts as Beneficiaries

- Applicable Multiple Beneficiary Trusts
  - A see through trust with multiple QDBs and at least one EDB
  - The proposed regulations defined two types:
    - ➢Type I – Divided immediately upon death into separate trusts
    - ➢Type II – Provides solely for a disabled or chronically ill EDB, until death of that person
  - A Type II trust is treated as an EDB regardless of the other beneficiaries
  - A Type II trust can be also be created when a Type I trust is split

Treas. Reg. §§ 1.401(a)(9)-4(g)

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Trusts as Beneficiaries

- Special rules for multiple designated beneficiaries
  - The general rule in the proposed regulations is that if a trust as multiple beneficiaries and at least one is not an EDB, the 10-year rule applies
  - Exceptions
    - ➢1. If any designed beneficiary is a minor child of the employee, the life expectancy distribution rules apply until the age of majority and the 10-year rule applies thereafter.
    - ➢2. A Type II Applicable Multiple Beneficiary Trust

Treas. Reg. §§ 1.401(a)(9)-4

Trusts as Beneficiaries

- Applicable Multiple Beneficiary Trusts
  - SNT & Type II trusts:
    - ➢A SNT usually includes provisions providing the disabled individual loses their interest in the trust in the event the interest causes losses of mean-tested benefits
    - ➢Treasury is seeking comments regarding how a trust can include this provision while not providing for trust payments to any other individual until the death of the disabled individual

Treas. Reg. §§ 1.401(a)(9)

Trusts as Beneficiaries

- Documentation Requirements – Post-mortem Minimum Distributions
  - Trustee must provide the custodian a list of beneficiaries or a copy of the trust instrument
  - If a beneficiary list is provided the trustee must:
    - Include a description of the conditions on their entitlement sufficient to establish who are the beneficiaries
    - Certifies that, to the best of the trustee's knowledge, this list is correct and complete and the trust is a QDB
  - Submission Deadline: October 31 of the calendar year following the calendar year of death

Treas. Reg. §§ 1.401(a)(9)-4(h)

Required Minimum Distributions from Defined Contribution Plans §1.401(a)(9)-5

RMDs from DC Plans

- The existing general rules are maintained
- The "applicable divisor" is renamed the "applicable denominator"
- The proposed regulations also outline events which require full distribution

Treas. Reg. §§ 1.401(a)(9)-5

Post-mortem Distributions

- Death on or After the RBD:
  - Designated Beneficiary – the applicable dominator is the greater of:
    - ➢ The DB's remaining life expectancy
    - ➢ The decedent's remaining life expectancy ("Ghost" life expectancy rule)
  - No Designated Beneficiary – the applicable dominator is the decedent's remaining life expectancy
  - All life expectancies are determined using the single life table for this purpose
    - ➢ The decedent's remaining life expectancy is determined in the calendar year of death and reduced by one in each subsequent year (subtract one method)
    - ➢ A non-Spouse DB's life expectancy is also determined in the calendar year of death and reduced by one in each subsequent year(subtract one method)

Treas. Reg. § 1.401(a)(9)-5(d)

Post-mortem Distributions

- Life expectancy to compute the applicable denominator:
  - Determined using the single life table
  - The decedent's remaining life expectancy is determined in the calendar year of death and reduced by one in each subsequent year
  - A non-Spouse DB's life expectancy is also determined in the calendar year of death and reduced by one in each subsequent year
  - A surviving spouse's life expectancy is redetermined annually

Treas. Reg. §§ 1.401(a)(9)-5(d)(3)

Post-mortem Distributions

- Distribution of Entire Interest Required on the earliest of the Following:
  (1) End of the 10^{th} year following the calendar year in which the employee died if the DB is not an EDB
  (2) End of the 10^{th} year following the calendar year in which the DB died, if the DB was an EDB
  (3) End of the 10^{th} year following the calendar year the beneficiary reaches the age of majority if the DB was a minor child EDB
  (4) End of the calendar year in which the applicable denominator is less than or equal to 1, if life expectancy distributions apply.

Treas. Reg. §§ 1.401(a)(9)-5(e)

Post-mortem Distributions

The general rules are maintained:

	Eligible DB	Qualified DB	No Qualified DB
Death Before RBD	*EBD's Life Expectancy Annual RMDs*	10-Year Rule *(No Annual RMDs)*	5-Year Rule *(No Annual RMDs)*
Death After RBD	*EBD's Life Expectancy Annual RMDs*	Life Expectancy Annual RMDs & the 10-Year Rule*	Ghost *Life Expectancy Annual RMDs*

*Annual RMDs may not be required for Roth IRAs & the greater of decedent's or DB's life expectancy is used

Treas. Reg. § 1.401(a)(9)(E)(ii)(IV)

Post-mortem Distributions

- Multiple Designated Beneficiaries
  - The proposed regulations require the applicable denominator is determined using the life expectancy of the oldest DB – rather than the beneficiary with the shortest life expectancy
  - The proposed regulations also require the life expectancy of the oldest DB will generally be used to determine whether a full distribution is required

Treas. Reg. § 1.401(a)(9)-5(f)

Post-mortem Distributions

- Multiple Designated Beneficiaries
  - *First Exception*: For a Type II Applicable Multi-Beneficiary Trust, then only the disabled and chronically ill beneficiaries of the trust are taken into account in determining the oldest beneficiary
    - ➢ All ages are disregarded, except the age of the disabled or chronically ill beneficiary
    - ➢ The death of the (last) disabled or chronically ill beneficiary triggers the 10-year rule
  - *Second Exception*: If any of the beneficiaries qualifies as a minor child EDB, only the age any minor child EBD is taken into account
    - ➢ Death of an older DB, who is not an EDB, will trigger the 10-year rule and require a full distribution before the oldest child reaches the age of majority plus 10-years.

Treas. Reg. § 1.401(a)(9)-5(f)

Special Rules §1.401(a)(9)-8

Special Rules

- Separate account treatment for beneficiaries
  - Continues the existing regulation rules to prohibit applying the 401(a)(9) rules to separate shares in a trust
  - However, an exception is added to accommodate the new multi-beneficiary trust rules – specifically the separate application of the rules to Type I subtrusts
- Definition of a spouse (updated to include the post-Obergefell regulations under §301.7701-18)
- Application of the qualified domestic relations order (QDRO) rules

§1.402(c)-2
Eligible Rollover Distributions

Rollovers

- The general rule that a 60-day rollover is income tax-free is preserved
- No limit on the number of rollovers from a qualified plan, but the 60-day deadline applies separately to each distribution

Treas. Reg. § 1.402(c)-2(a)

Roth Rollovers

- However, if any portion of the rollover distribution is to a Roth IRA and the distribution is not from a designated Roth account, that portion is includible in the taxpayer's gross income but generally not subject to the 10-percent additional tax

Treas. Reg. § 1.402(c)-2(b)(1)(i)

Extensions & Exceptions

- Extensions of and Exceptions to the 60-day Rollover Deadline
  – The existing rules allowing waivers are retained
  – In addition, the proposed regulations provide that the 60-day period does not include any period during which the amount transferred to the employee is a frozen deposit described in section 402(c)(7)(B), and does not end earlier than 10 days after that amount ceases to be a frozen deposit
  – The proposed regulations also clarify that in the case of a repayment of a distribution treated as a rollover (such as a qualified disaster distribution), the repayment timing requirements in the statutory provision giving rise to that treatment take precedence over the otherwise applicable 60-day period

Treas. Reg. § 1.402(c)-2(b)(2)

Rollovers & Basis

- Basis can only be rolled over via a trustee-to-trustee transfer
- The proposed regulations require any rollover which includes basis, when only a portion of the distribution is rolled over, the portion rolled over first consists of the portion which is not basis
- There is also a provision that allows property to be distributed, sold and the sale proceeds then recontributed as a rollover

Treas. Reg. §§ 1.402(c)-2(b)(3), (4)

Distribution Requirements for IRAs §1.408-8

Distribution Requirements for IRAs

- The proposed regulations change the spousal rollover rules to accommodate SECURE Act changes:
  - If the employee dies before the RBD and designates the surviving spouse as beneficiary, and surviving spouse conducts a rollover from a qualified plan or IRA to an IRA in the name of decedent, any distribution method elected under the distributing IRA or qualified plan continues to apply
  - A surviving spouse to whom the 5 or 10-year rules applies can rollover a distribution to an IRA in the decedent's name and elect the life expectancy rule

Distribution Requirements for IRAs

- The proposed regulations change the spousal rollover rules to accommodate SECURE Act changes:
  - These rules do not apply to a surviving spouse who makes a rollover distribution to their own IRA – the spousal rollover election must be made by the later of: (1) the calendar year in which the surviving spouse reaches age 72, or (2) the end of the calendar year following the calendar of the IRA owner's death; late rollovers are subject to catch-up RMDs

Distribution Requirements for IRAs

- The proposed regulations change the RBD to 72 and reaffirm Roth RMDs are not required.

- Similar rules are also created for EBDs
  - If an EBD elects the 10-year rule, any rollover from a plan to an IRA in the name of the decedent remains subject to the 10-year rule
  - However, if the distribution is made by the end of the calendar year following the year the employee dies, then the beneficiary would be permitted to make an election to have the life expectancy rule apply under the IRA

Excise Tax on Accumulations in Qualified Retirement Plans § 54.4974-1

Excise Tax on Accumulations

- The proposed regulations modify the rules to accommodate the new 10-year rule.
- The proposed regulations also provide two situations in which an automatic waiver of the excise tax applies:
  - First Situation: (1)The employee died before the RBD, (2) The payee is an EDB who failed to make an affirmative election to use the life expectancy rule, (3) payee failed to make RMDs, and (4) the payee elects the 10-year rule applies
  - Second Situation: (1) Individual dies before making their RMD (2) beneficiary fails to make the RMD before the end of the calendar year, (3) The beneficiary makes the RMD before the beneficiary's tax filing deadline, including extensions

PRACTICAL EXAMPLES

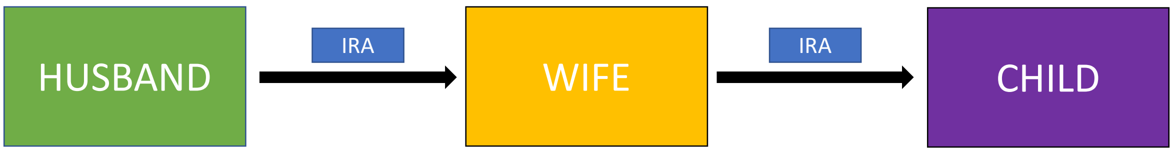
IRAs at Death & Beyond

Example 1: Husband to Wife

- **Spousal rollover available.** The Uniform Lifetime Table is used to compute RMDs. No RMDs required for Roth IRAs.
- **Inherited IRA available.** EDB rules apply for wife's distributions. RMDs based on the wife's life expectancy and the Single Life Table. The Wife's life expectancy is redetermined annually (The Subtract-One Method does not apply). Also, distributions can be delayed until the Wife's RBD.

IRAs at Death & Beyond

Example 2: Husband to Wife to Child



- **Spousal rollover available**. The Uniform Lifetime Table is used to compute RMDs. No RMDs required for Roth IRAs during wife's life. At wife's death, the 10-year rule applies with RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method. At Wife's death, the 10-year rule applies with RMDs.
- **Inherited IRA available**. EDB rules apply for wife's distributions. RMDs based on the wife's life expectancy and the Single Life Table. The Wife's life expectancy is redetermined annually (The Subtract-One Method does not apply). Also, distributions can be delayed until the Wife's RBD, despite it being an "inherited" IRA. At Wife's death, the 10-year rule applies without RMDs.

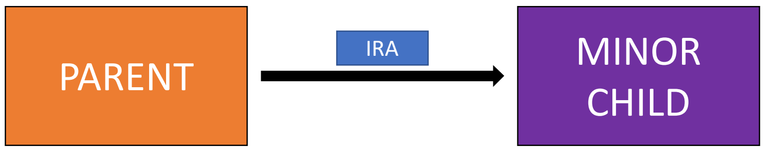
IRAs at Death & Beyond

Example 3: Parent to Adult Child

- The 10-year rule applies with RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- No 10-year rule RMDs required if Parent dies before their RBD
- No 10-year rule RMDs required for Roth IRAs.

IRAs at Death & Beyond

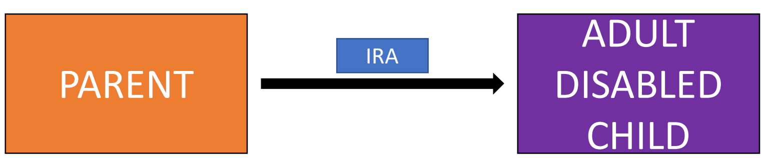
Example 4: Parent to Minor Child



- EDB rules apply. RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- When the child reaches the age of majority, the 10-year rule without RMDs applies.

IRAs at Death & Beyond

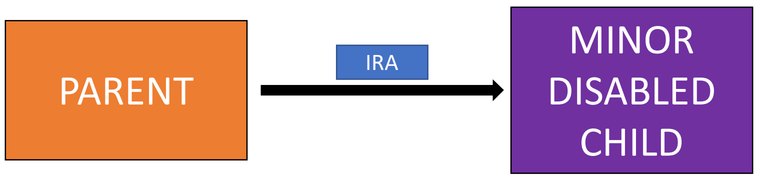
Example 5: Parent to Adult Disabled Child



- EDB rules apply. RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- Documentation of disability must be provided to the custodian at the parent's death.
- At the Disabled Child's death, the 10-year rule without RMDs applies

IRAs at Death & Beyond

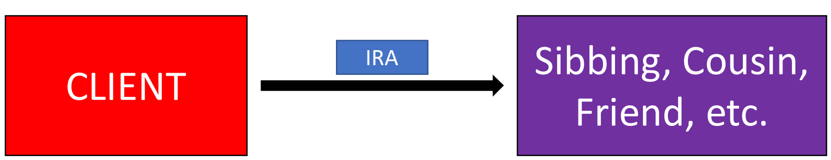
Example 6: Parent to Minor Disabled Child



- EDB rules apply. RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- Documentation of disability must be provided to the custodian at the parent's death.
- If documentation is not provided timely, the 10-year rule applies when the child reaches the age of majority. The child cannot become disabled after the parent dies and qualify as disabled EDB.

IRAs at Death & Beyond

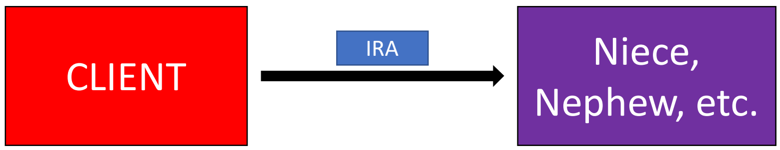
Example 7: Client to Sibling, Cousin, Friend, etc. (beneficiary of similar age)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled, chronically ill, or not more than 10-years younger than the client. In that case, RMDs based on beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.
- If the EBD rule applies, at the beneficiary's death the 10-year rule will apply without RMDs.

IRAs at Death & Beyond

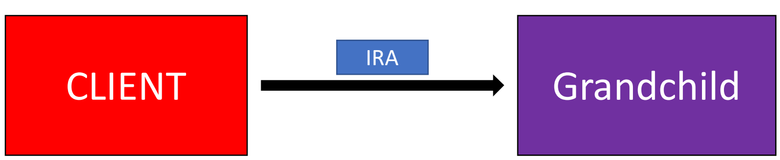
Example 8: Client to Niece, Nephew, etc. (younger beneficiary)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled or chronically ill. RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.
- If the EBD rule applies, at the beneficiary’s death the 10-year rule will apply without RMDs.

IRAs at Death & Beyond

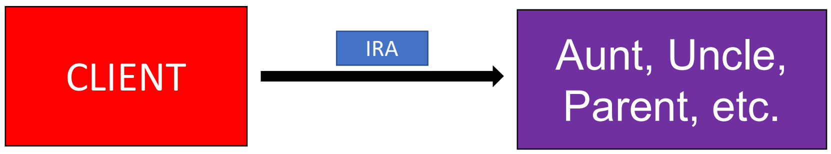
Example 9: Client to Niece, Nephew, etc. (much younger beneficiary)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled or chronically ill. RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.

IRAs at Death & Beyond

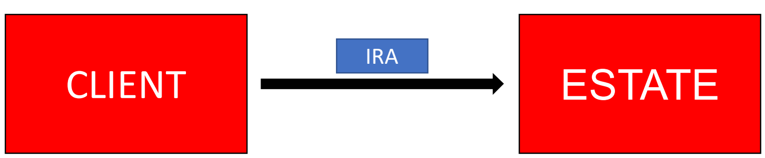
Example 10: Client to Aunt, Uncle, Parent, etc. (older beneficiary)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled or chronically ill. RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.

IRAs at Death & Beyond

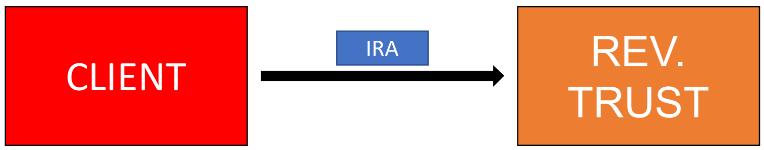
Example 11: Client to their Estate



- An estate is not a Qualified Designed Beneficiary
- If the client dies their Require Beginning Date (RBD), a the 5-year rule applies. No RMDs, but full distribution must occur within 5-years.
- If the client dies after the RBD, the "Ghost" Life Expectancy rule applies. The RMD denominator is computed using decedents remaining life expectancy according to the Single Life Table using the subtract-one method.

IRAs at Death & Beyond

Example 12: Client to their Rev. Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. The 10-year rule applies, but no RMDs for Roths.
- The 5-year rule, ghost life expectancy rule or EDB rules could apply but it would be dependent on the circumstances surrounding death & how the trust is drafted.

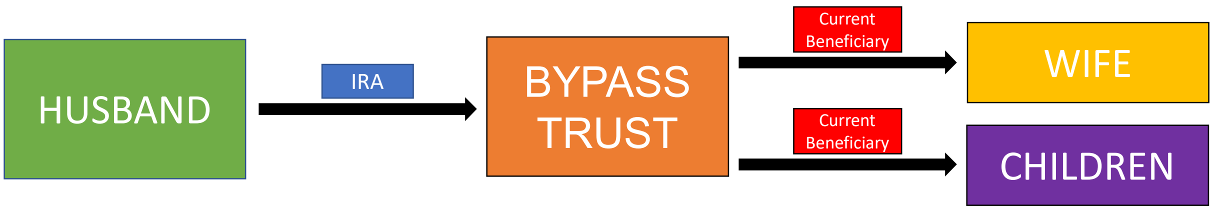
IRAs at Death & Beyond

Example 13: Client to their Bypass Trust

- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. The 10-year rule applies, but no RMDs for Roths.
- The 5-year rule, ghost life expectancy rule or EDB rules could apply but it would be dependent on the circumstances surrounding death & how the trust is drafted.

IRAs at Death & Beyond

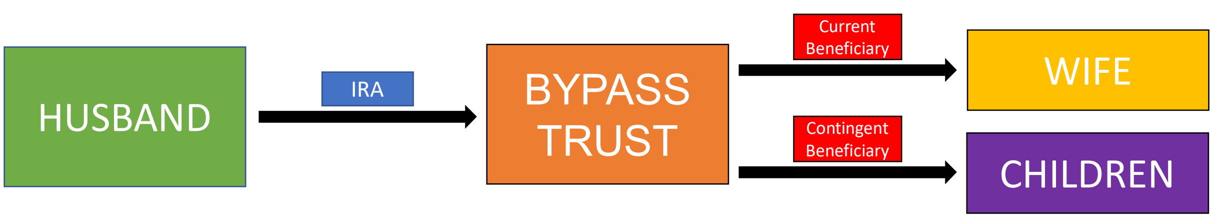
Example 14: Husband to Bypass Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. The 10-year rule applies, but no RMDs for Roths.

IRAs at Death & Beyond

Example 15: Husband to Bypass Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. If 10-year rule applies, to a Roth IRA there will be no RMDs.
- However, if the Surviving Spouse is chronically ill or disabled and the children's interest is contingent on her death, EBD treatment based on the wife's life may be possible.

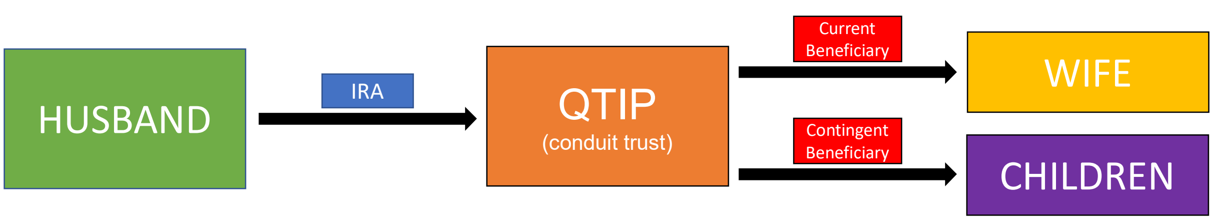
IRAs at Death & Beyond

Example 16: Husband to QTIP Trust

- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. If 10-year rule applies, to a Roth IRA there will be no RMDs.
- However, if the Surviving Spouse is chronically ill or disabled and the children's interest is contingent on her death, EBD treatment based on the wife's life may be possible.

IRAs at Death & Beyond

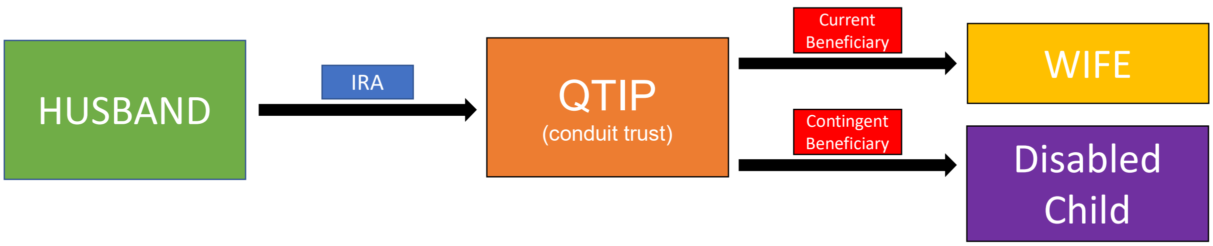
Example 17: Husband to QTIP Trust



- If the QTIP is a conduit trust, EDB treatment based on the wife's life expectancy is available. The single life table and subtract-one method is used. Moreover, the wife can wait until the earlier of when she reaches her RBD or when her decreased husbanded (would have) reached his RBD to begin distributions.
- When the wife dies, the 10-year rule with no RMDs applies.

IRAs at Death & Beyond

Example 18: Husband to QTIP Trust



- If the contingent beneficiary is a disabled child, EDB life expectancy distributions may be able to continue based on the child's life expectancy.

IRAs at Death & Beyond

Example 19: Trust for a Minor Child

- If a current trust beneficiary is the deceased client's minor child, EDB treatment is available and is generally not limited by other beneficiaries. The single life table and subtract-one method is used. When the child reaches the age of majority, the 10-year rule without RMDs applies.

IRAs at Death & Beyond

Example 20: Trust for a Disabled Person

- If a current trust beneficiary is disabled and the only interest(s) are contingent on the death of the disabled beneficiary, EDB treatment is available. The single life table and subtract-one method is used. When the disabled person dies, the 10-year rule without RMDs applies.

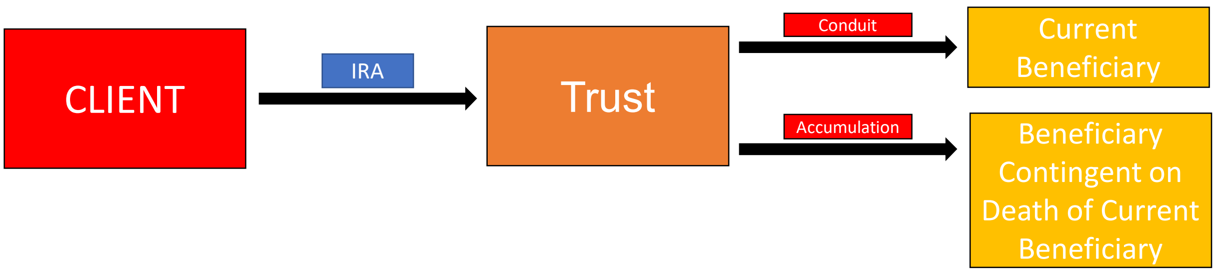
IRAs at Death & Beyond

Example 21: Charity as a Remote Contingent Beneficiary

- If a charity's potential interest in an IRA is contingent on the death of a beneficiary with merely a residual interest in the IRA, the charity can be disregarded.
- The trust can be treated as a qualified designated beneficiary and the Section 409(a) rules are applied ignoring the charity's interest.

IRAs at Death & Beyond

Example 22: Conduit to Accumulation Trust



- If a conduit trust will switch to an accumulation trust at the death of the current beneficiary to an accumulation trust, the trust will be treated as a conduit currently

Conclusion