High Net Worth Family Tax Newsletter
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Welcome to Loeb & Loeb's High Net Worth Family Tax Report, bringing you in-depth articles highlighting important topics and providing practical insights for high net worth individuals, with a focus on trusts and estates, tax, family offices and tax-exempt organizations.

With 2023 fast approaching, our articles on 2022 year-end planning reminders and 2023 inflation adjustments summarize action items that individuals may want to consider as part of their tax planning for the rest of this year and into the next.

Senior counsel Christina Hammervold outlines the beneficial ownership information that many privately held entities will be required to report to the U.S. Department of the Treasury Financial Crimes Enforcement Network (FinCEN) under recently issued final regulations, which take effect on January 1, 2024. In our article on private placement life insurance, partners Mary Ann Mancini and Todd Steinberg and senior counsel Jennifer Smith provide an overview of the requirements, financial sophistication and risk tolerance needed for planning with this complex life insurance product.

Associate Caitlin Cline discusses the benefits and considerations in relying on portability to transfer unused federal estate tax exemption to a surviving spouse in light of the Internal Revenue Service's extension of time to make the portability election. And for non-New Yorkers owning or considering a New York vacation home, senior counsel Shu-Ping Shen reviews the taxpayer-friendly ruling declaring that a vacation home in New York will not automatically be considered a permanent place of abode for purposes of New York's income tax residency rules.

In this issue, we've also added a new section highlighting issues impacting family offices. In our first article,

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Bankruptcy partner Daniel B. Besikof and associate Noah Weingarten discuss the effect of recent crypto exchange bankruptcies on family offices and other high net worth investors, as well as trust and estate planning considerations to keep in mind when investing in crypto assets.

Finally, in case you missed it, partner Gabrielle Vidal, chair of Loeb's Guardianship practice, explains guardianship in California and how the Loeb team can help families navigate the complex and often emotionally charged process, in the most recent episode of our In the Know series, "Guardianships in California."

2022 Year-End Planning Reminders

The results of the recent mid-term elections mean we are unlikely to see significant tax changes in the near future, which should permit year-end planning with a relatively high degree of confidence. With 2023 fast approaching, individuals should review opportunities for year-end planning, including the following.

Make Annual Exclusion Gifts

In 2022, individuals can give up to $16,000 each to an unlimited number of recipients without reducing their lifetime gift or estate tax exemptions, paying gift tax or filing a federal gift tax return. Married couples can double the annual exclusion amount (to $32,000 per recipient) by electing on a gift tax return to "split" gifts. The annual exclusion is a "use it or lose it" proposition, however, since any unused 2022 annual exclusion will not carry over to 2023.

To qualify for the annual exclusion, a gift must be of a "present interest," so the donor should make the gift directly to the recipient or, if the gift is made to a trust, the trust must provide "Crummey" withdrawal powers that allow the intended beneficiary to withdraw an amount equal to the annual exclusion. A notification letter should generally be sent to the beneficiary. Trusts for grandchildren must be designed to qualify for the generation-skipping transfer (GST) tax exemption annual exclusion, or gifts to the trust will use a portion of the donor's lifetime GST tax exemption. Donors also should be aware that gifts made by check must be deposited by the recipient before the end of the year to qualify for the 2022 annual exclusion.

Consider Gifts Using Lifetime Exemption

In addition to annual exclusion gifts, each U.S. individual has a federal gift and estate tax exemption, which is currently $12.06 million and scheduled to increase to $12.92 million in 2023. Any exemption not used to shelter gifts made during life is available at death to shelter assets from federal estate taxes; however, unless the tax laws change, this exemption will drop to $5 million (adjusted for inflation) in 2026. Those individuals who have sufficient assets and a desire to make lifetime gifts may want consider, sooner rather than later, how to maximize their use of this temporarily higher gifting capacity.

Manage Capital Gains

Generally, capital gains and losses incurred in the same tax year will offset each other. Individuals should review their investment portfolios to determine whether they want to "harvest" capital losses to offset capital gains realized in 2022 or accelerate the realization of gains that may be absorbed by realized losses. But be aware of the "wash sale rules," which disallow the tax loss on the sale of a security if a "substantially identical" security is repurchased within a 30-day window before or after the sale.

Review Charitable Giving

Individuals who make regular charitable gifts may want to plan their donations to optimize the potential charitable deduction, such as bunching the donations into an expected high tax year. Consideration also should be given to the types of assets donated. For example, making a charitable donation of publicly traded stock that has a low basis (rather than selling it and donating the proceeds) can give the donor a charitable deduction equal to the fair market value of the stock at the time of donation (subject to applicable limitations) and eliminate the gain recognition that generally would be triggered upon the asset's sale.

Coordinate Deductions

In addition to charitable donations, individuals may wish to accelerate or delay other itemized deductions (such as medical costs and certain interest expenses), depending on their tax outlook for this year and next. Bundling available itemized deductions into a high tax year can help manage anticipated income tax liabilities.

Take RMDs

Individuals who must take required minimum distributions (RMDs) from qualified retirement plans and traditional IRAs should do so by Dec. 31 to avoid penalties. Note that charitably inclined individuals who have not yet taken 2022 RMDs (or who have attained age 70 1/2 even if they are not required to take RMDs) also may wish to consider making a qualified charitable distribution (QCD) from their traditional IRAs directly to one or more eligible public charities (not a donor advised fund or private foundation). QCDs, up to $100,000 total per year, do not count as taxable income and cannot be taken as charitable deductions but may count toward satisfaction of an individual's RMD.

2023 Inflation Adjustments for Personal Tax Planning

A number of provisions of the Internal Revenue Code provide for annual adjustments of dollar amounts based on certain inflation criteria. The IRS has announced the adjustments for 2023, which are as follows:

Gift, Estate and Generation-Skipping Transfer (GST) Taxes

The 2023 inflation adjustments for the gift, estate and GST tax exemptions are fairly significant, increasing by almost $900,000 from 2022:

- **Unified Gift and Estate Tax Exemption:** For gifts made and estates of decedents dying in 2023, the exemption amount will increase to $12,920,000 (up from $12,060,000 in 2022).
- **GST Tax Exemption:** The GST tax exemption also increases to $12,920,000 in 2023 for generation-skipping transfers (up from $12,060,000 in 2022).
- **Gift Tax Annual Exclusion:** The gift tax annual exclusion increases to $17,000 for gifts made in 2023 (up from $16,000 in 2022).
- **Annual Exclusion for Gifts to Non-U.S. Citizen Spouses:** For gifts made to non-U.S. citizen spouses in 2023, the annual exclusion increases to $175,000 (up from $164,000 in 2022).

Income Taxes

Income Tax Brackets: The 2023 tax brackets for individuals as well as trusts and estates also have been adjusted upward:

- **Married joint filers:** The top tax rate of 37% applies to taxable income over $693,750 in 2023 (up from $647,850 in 2022).
- **Single Filers:** The top tax rate of 37% applies to taxable income over $578,125 in 2023 (up from $539,900 in 2022).
- **Trusts and Estates:** Trust and estates have a far more compressed tax bracket, and the top tax rate of 37% applies to taxable income over $14,450 in 2023 (up from $13,450 in 2022).

Capital Gains Thresholds: Below are the increased thresholds for application of the 15% capital gains tax rate. The 20% capital gains tax rate will apply to adjusted net capital gains in excess of the 15% maximum amounts.

- **Married Joint Filers:** The 15% capital gains tax rate applies to adjusted capital gains of more than $89,250 and up to $553,850 (up from $83,350 to $517,200 in 2022).
- **Single Filers:** The 15% capital gains tax rate applies to adjusted capital gains of more than $44,625 and up to $276,900 (up from $41,675 and $258,600 in 2022).
- **Trusts and Estates:** The 15% capital gains tax rate applies to adjusted capital gains of more than $3,000 and up to $14,650 (up from $2,800 and $13,700 in 2022).

All of the above, however, could be changed if the incoming Congress enacts any modifications to the current income or transfer tax laws. As always, you should contact your Loeb estate planning attorney for advice prior to taking any tax planning actions.

FinCEN Issues Final Rules Requiring Beneficial Ownership Reporting by Privately Held LLCs and Other Entities Effective January 1, 2024

Many privately held limited liability companies (LLCs), corporations and other entities formed or registered to do business within the U.S. will soon be required under federal regulations to file reports to disclose their beneficial ownership and to update those reports to reflect changes to their beneficial ownership on an ongoing basis.

Key Takeaways

- The requirements will apply to privately held corporations, LLCs and other entities formed or registered to do business in any U.S. state (or with any American Indian tribe) for any purpose, including for estate, investment, real estate, tax, privacy or other personal planning.
- While most trusts used for estate planning would not be considered reporting companies under these requirements, information about a trust's beneficial owners (grantors/settlors, beneficiaries, trustees, etc.) may be reportable if the trust directly or indirectly owns an interest in an entity qualifying as a reporting company.
- The new reporting requirements will take effect on Jan. 1, 2024, with reporting companies created or registered before that date required to file their initial reports by Jan. 1, 2025. Reporting companies created or registered on or after Jan. 1, 2024, must file within 30 days of creation or registration.
- The beneficial ownership information reported to the U.S. Department of the Treasury Financial Crimes Enforcement Network (FinCEN) will be accessible to authorized government entities but will not be part of any publicly accessible database.

Overview

The new reporting requirements are the result of federal legislation, the Corporate Transparency Act (CTA), enacted on Jan. 1, 2021. The final reporting regulations released by FinCEN, which take effect on Jan. 1, 2024, implement the CTA's requirements and will subject millions of privately held entities to beneficial ownership reporting obligations. These reporting requirements are purposely broad and designed to help prevent and combat the use of entities for illicit activities by targeting smaller, unregulated companies that may act as shell companies in money laundering schemes. While these final regulations retain the overall structure of previously issued proposed regulations, FinCEN has incorporated helpful modifications and clarifications to the rules in response to numerous comments, including minimizing reporting obligations related to "applicants" and increasing the amount of time certain reporting companies have to file initial reports and corrected reports. FinCEN also provided useful commentary and examples as to how the final rules apply.

Who Must File Beneficial Ownership Reports?

Reporting Companies. The CTA imposes filing obligations on "reporting companies," which include both:

- Domestic reporting companies, including corporations, LLCs and other entities created by the filing of a document with a secretary of state or any similar office under the law of a state or American Indian tribe.
- Foreign reporting companies, including non-U.S. entities that are registered to do business in any state or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a state or American Indian tribe.

Only an entity that is created or registered to do business by the filing of a document with a U.S. state or American Indian tribe falls within the definition of reporting company. As a result, most trusts used for estate planning purposes should not qualify as reporting companies, since such trusts generally are not created (nor registered to do business) by the filing of a document with a government authority (with the exception of statutory trusts or Massachusetts business trusts). Information about any trust's "beneficial owners" as determined under the final regulations (e.g., settlors, beneficiaries, trustees) may nonetheless end up being reported to FinCEN if the trust directly or indirectly owns an interest in a reporting company.

Most sole proprietorships, general partnerships and non-U.S. entities not registered to do business in the U.S. should similarly not fall within the definition of reporting company.

Exempt Entities. The CTA exempts certain entities from reporting, including highly regulated entities and other entities that have been identified as posing a low risk for money laundering and other financial crimes (e.g., large operating companies with a physical presence in the U.S.). Most privately held entities used for personal estate, tax or privacy planning generally will not be exempt.

Family Offices. Most family offices in the U.S. will be reporting companies, as they are typically organized as LLCs, limited partnerships or corporations. However, some family offices may qualify for an exemption. In the case of family offices, the most relevant exemption categories are likely the exemptions for large operating companies, investment advisers registered under the Investment Advisers Act of 1940 and "venture capital fund advisers" under the Investment Advisers Act. In order to qualify for the large operating company exemption, family offices must have more than 20 full-time employees in the U.S., U.S.-sourced gross receipts in excess of $5 million and an operating presence at a physical office in the U.S.

Who Must Be Identified in the Reports?

The CTA requires two categories of individuals to be identified in beneficial ownership reports: (1) beneficial owners and (2) applicants.

Beneficial Owner. The term "beneficial owner" means any individual who, directly or indirectly, does one of the following:

- Exercises substantial control over the reporting company
- Owns or controls not less than 25% of the ownership interests of the reporting company

"Substantial control" is defined in the final regulations to include (1) service as a senior officer, (2) authority to appoint or remove any senior officer or a majority of the board (or similar body), (3) directing, determining or having substantial influence over important decisions made by the reporting company and (4) any other form of substantial control. Each individual who has substantial control must be identified and reported. Given the breadth and vagueness of this test, it may be difficult to apply to multi-tier structures involving companies and trusts.

With respect to the disclosure of individuals who own or control at least 25% of the ownership interests, the final regulations define ownership interests broadly to include equity as well as other types of interests (such as capital or profit interests, convertible instruments, futures, warrants, options, etc.). An ownership interest can be owned or controlled directly or indirectly through a variety of means, including joint ownership or through a trust.

If an ownership interest in a reporting company is held through a trust, each of the individuals listed below are deemed to have an ownership interest in that reporting company:

- A grantor/settlor who has the right to revoke the trust or otherwise withdraw the trust's assets
- A beneficiary who is the sole permissible recipient of the trust's income and principal
- A beneficiary who has the right to demand a distribution of or withdraw substantially all of the trust's assets
- A trustee of the trust
- Any other individual who has the authority to dispose of trust assets

The final regulations emphasize that the above categories are merely examples and do not address all applications under which individuals may be considered to own or control ownership interests through a trust. FinCEN has not provided guidance on whether trust protectors, distribution or investment advisors of trusts or beneficiaries of trusts with multiple beneficiaries must be reported.

Certain categories of individuals are excluded from the definition of beneficial owner, including minors (provided that information for a parent/guardian is provided); nominees, intermediaries, custodians and agents acting on behalf of others; individuals acting solely as employees (but only if they are not senior officers); individuals whose only interest is through a right of inheritance; and creditors. Information regarding these individuals would still need to be disclosed if they qualify as "applicants," however.

Applicant. The final regulations define the term "applicant" to include the following one or two individuals:

- The individual who directly files the document that creates or registers the entity
- The individual who is primarily responsible for directing or controlling the filing of the document, if more than one individual is involved in the filing of the document

The final regulations have limited the information that reporting companies must report for applicants as follows: (1) reporting companies formed or registered before Jan. 1, 2024, will not have to report their applicants and (2) reporting companies formed or registered on or after that date must report information about their applicants but will not be required to update the information if there are subsequent changes.

What Information Must Be Reported?

All reporting companies must disclose the information below for each beneficial owner, and reporting companies formed or registered on or after Jan. 1, 2024, also must disclose the information below for each applicant:

- Full legal name
- Date of birth
- Current street address
- Identification number from an acceptable identification document (such as an unexpired passport or driver's license), along with the jurisdiction that issued the document
- An image of the identification document showing both the individual's photograph and the identification number

Alternatively, individuals can apply for and use a FinCEN identifier number (FIN) by providing FinCEN with the above information. The required information must be updated whenever there is a change. A FIN could simplify the process for updating reports, particularly where the same beneficial owner has been reported for multiple entities. Updates to the FIN information should apply to every report in which the FIN was used so that each separate entity report does not need to be independently tracked and updated.

A reporting company also must provide information about itself, including the full name of the company, any trade or "doing business as" name, the business street address, the jurisdiction of formation, the jurisdiction where the company first registered to do business in the U.S. (in the case of foreign reporting companies) and the IRS taxpayer identification number (TIN). If a foreign reporting company does not have a TIN, it will be required to provide a foreign tax identification number, along with the name of the jurisdiction that issued the number.

All reports and applications submitted to FinCEN under the CTA require a certification that the reported information is "true, correct, and complete."

When Must Reports Be Filed or Updated?

Reporting obligations will take effect on Jan. 1, 2024, although new and existing entities have different filing deadlines:

- Entities formed/registered before Jan. 1, 2024, must file initial reports no later than Jan. 1, 2025.
- Entities formed or registered on or after Jan. 1, 2024, must file an initial report within 30 days of the date they are formed/registered.

For purposes of filing an initial report for a new entity, the 30-day period starts on the earlier of (1) the date on which the reporting company receives actual notice that its creation or registration has become effective or (2) the date on which a secretary of state (or similar office) first provides public notice (such as through a publicly accessible registry) that the reporting company has been created or registered.

Reporting companies also must timely update information or correct any inaccurate information contained in a previously filed report. The final regulations give reporting companies 30 days to file updates (e.g., to report changes in beneficial ownership and any change with respect to the information reported for the reporting company or a beneficial owner, such as an address change) or to correct inaccurate reports. Changes in beneficial ownership when an individual dies must be reported within 30 days of the settlement of the deceased individual's estate if the individual was a beneficial owner "by virtue of property interests or other rights subject to transfer upon death."

With respect to previously reported information on applicants, reporting companies are not required to report updates to applicant information but must correct any inaccurate information. A reporting company also must file updated reports if:

- A minor who is a beneficial owner of the company attains the age of majority (if information for a parent/guardian, instead of for the minor, was previously reported)
- The company was previously exempt but no longer meets exemption criteria
- The company filed an initial report but now meets exemption criteria

FinCEN has clarified that it does not expect a reporting company to file an updated report upon company termination or dissolution.

The final regulations do not currently allow reporting companies to seek extensions to the filing periods for initial, updated or corrected reports, but FinCEN has said that it may consider providing guidance or relief as appropriate, depending on the facts and circumstances.

Will the Information Be Publicly Available?

No, the database will not be available to the public.

Who Will Have Access to the Information?

All information reported under the final rules will be stored in a secure private database maintained by FinCEN. The information will be available only in limited situations upon appropriate request by U.S. federal law enforcement agencies (including requests made by U.S. federal authorities on behalf of non-U.S. law enforcement), state and local law enforcement with court authorization for such information, financial institutions that have the consent of the business entity in question and certain federal regulatory agencies. The Treasury Department has its own broad authorization to use the information, including for tax-related purposes.

The CTA imposes penalties for the unauthorized disclosure or use of the information. FinCEN will issue additional regulations to address who may access beneficial ownership information, for what purposes and required safeguards.

What Are the Penalties for Noncompliance?

Civil and criminal penalties may apply to willful failures to file an initial report, an updated report or a corrected report, as well as willfully providing (or attempting to provide) false or fraudulent beneficial ownership information. The civil penalty is $500 per day. Criminal penalties may include a fine of up to $10,000 and/or imprisonment for up to two years. Penalties may apply to reporting companies as well as to responsible individuals and other entities. For an individual, penalties may apply to the extent such individual causes the failure or is a senior officer of a reporting company when it willfully fails to report complete, accurate or updated beneficial ownership information. Individuals also may be subject to penalties with respect to applications to FinCEN for FINs. Noncomplying entities also will likely find it difficult to open or maintain a bank account, particularly in the U.S.

What Should I Do Now?

In the coming year, family offices and individuals who have created entities as part of their personal planning should review their entities and trusts and start gathering the information that will become reportable beginning in 2024. Those who are considering creating new entities for personal planning reasons next year may wish to consider whether existing entities can be used. At a minimum, it would be preferable to form new entities in 2023 (as opposed to 2024), as entities created in 2023 will have until Jan. 1, 2025, to file initial reports, while entities created in 2024 will have to file initial reports within 30 days of creation.

Family Office Feature: Bankruptcy and Estate Planning Considerations for Crypto Assets

The market for crypto assets has recently experienced significant tumult as evidenced by the bankruptcy filings of several key crypto players, including Three Arrows Capital, Voyager Digital, Celsius Networks, FTX and, most recently, BlockFi. These bankruptcy cases give rise to numerous issues for investors holding crypto assets, which can be mitigated with proper diligence and planning. In addition, there are several estate planning and trust-specific considerations that should be addressed when holding crypto assets (or determining whether to invest in crypto assets).

Risks to Customers of Bankruptcy Filing by Crypto Exchange

Investors in crypto assets face significant risk—particularly in the current marketplace—that the custodian or exchange on which they hold their crypto assets could file for bankruptcy. A number of major crypto exchanges have filed for bankruptcy in recent months—including FTX, which, until its shocking failure, was a darling of the crypto industry and a source of capital and bailouts for other crypto-related businesses. When a crypto exchange files for bankruptcy, its customers may be treated as unsecured creditors and repaid just cents on the dollar. Moreover, if a customer was fortunate (or prescient) enough to withdraw his or her crypto assets in the 90 days before the bankruptcy filing, those withdrawals may be subject to "clawback" claims by the bankruptcy estate. A number of issues underlie those risks.

Are crypto assets in a debtor's custody property of the bankruptcy estate?

All property possessed by a debtor as of its bankruptcy filing is property of the bankruptcy estate unless an exception applies. A key exception is property held in trust for the benefit of a customer or other third party. The issue of whether crypto assets are estate property or customer property is critically important. When a crypto asset is property of the bankruptcy estate, the customer who deposited that asset is a creditor (generally an unsecured creditor), and that customer can expect to recover perhaps just pennies on the dollar. If the coins are not property of the estate, customers should be able to recover those coins in full, assuming they are still being maintained by the exchange.

The following considerations are relevant in determining whether crypto assets are the property of the bankruptcy estate:

- **The Terms of Use.** Each exchange has unique terms of use. Even within a single exchange, there may be multiple products offered to customers, each with unique terms. Many of those terms of use provide for ownership of the customers' coins to be transferred to the exchange. In those instances, the customers' coins are likely to be property of the bankruptcy estate. Other terms of use provide for the customer to maintain title to the crypto assets, which suggests that coins may not be estate property—particularly if the terms provide that the crypto assets will be (and actually are) held in a segregated account. This issue is being heavily litigated in the Celsius bankruptcy cases. The results there may provide guidance for similar future cases.
- **Applicable State Law.** Bankruptcy law refers to state law to determine whether assets are property of the estate. Certain states have customer protection statutes that require custodied crypto assets to be held in trust for the customer or for crypto custodians to maintain surety bonds to backstop the custodian's liabilities to customers. Laws applying to money transmitters (e.g., PayPal or Western Union) or other laws that govern the relationship between customers and exchanges/custodians may also bear on this analysis.

Can withdrawals of crypto assets be clawed back as preferences?

Bankrupt debtors (or trustees representing their estates) are permitted to seek to recover transfers made to creditors in the 90 days before bankruptcy filing as so-called "preferential transfers." The preference laws are designed to ensure that all creditors of equal priority are treated equally and that no creditor is "preferred" to another shortly before a bankruptcy filing.

These preference claims have never been asserted in the bankruptcy case of a crypto exchange or custodian, so the law is unsettled. Customers have numerous defenses to these potential claims, all of which we assume will be litigated in the coming months and years.

- **Withdrawal Not of Debtor Property.** The bankruptcy estate can recover a transfer as preferential only if it was a transfer of estate property. As discussed above, whether a customer's coins are property of the bankruptcy estate is a fact-intensive analysis. This issue is important to other aspects of the bankruptcy case as well, so it likely will be litigated even before preference suits are brought. Customers with potential preference exposure need to be careful in monitoring the bankruptcy cases to ensure they have a voice on this issue.

- **Insolvency.** Transfers are avoidable as preferences only if they were made when the debtor was insolvent. While there is a presumption of insolvency during the 90-day period before bankruptcy, customers can rebut that presumption by presenting evidence of solvency. The volatility in the crypto markets complicates the analysis because the daily swings could result in a shifting solvency picture. Challenging solvency is an expensive proposition involving expert witnesses, so customers seeking to challenge insolvency will likely want to pool their resources to the extent possible.
- **Affirmative Defenses Apply.** The bankruptcy code provides creditors with a number of other defenses to preference suits, including the "ordinary course" and "subsequent new value" defenses, as well as securities safe harbor provisions.
    - **Ordinary Course Defense.** Withdrawals made in the ordinary course of business are not subject to avoidance as a preference. What constitutes ordinary course of business is not defined in the Bankruptcy Code and is a fact-intensive inquiry. Most terms of use provide that customers can withdraw their crypto assets on demand. Customers will certainly argue that withdrawals made in compliance with the customer agreement (i.e., fulfillment of "on demand" withdrawal requests) constitute "ordinary course" transactions.
    - **Subsequent New Value Defense.** A customer is entitled to a credit against a clawback claim to the extent the customer provided value to the debtor after receiving the withdrawal at issue. The subsequent new value defense may apply if, for example, the customer deposited additional assets after the subject withdrawal.
    - **Securities Safe Harbors.** The Bankruptcy Code's securities safe harbor provisions insulate certain transactions involving securities from preference exposure. One key open question regarding this defense is whether crypto assets are "securities" to which the safe harbor defenses would apply.

Tips for Mitigating Bankruptcy Risk

While bankruptcy is ravaging the crypto industry, investors can take some relatively straightforward preventative steps to protect transactions.

- **Review Terms of Use.** While terms of use are long and complex, customers need to understand the terms that govern their investment. Accordingly, they must carefully review (and potentially have counsel review) the terms of use to understand the risks associated with the customer's crypto exchange. Terms of use are generally not negotiable, but it is still important to understand the governing provisions and their impact on investor rights.
- **Withdraw Crypto Assets or Move Them to a Different Custodian.** If a customer is concerned that his or her crypto exchange is in danger of insolvency, the customer should withdraw the crypto assets from the exchange. As we have seen, crypto insolvencies move swiftly, and terms of use often permit exchanges to freeze customer funds, even in advance of a bankruptcy filing. So moving quickly is key. Those assets could be moved to a different, safer custodian or, as discussed below, to a hardware wallet or other cold storage.
- **Store Crypto Assets in Hardware Wallets or Other "Cold" Storage.** Instead of maintaining crypto assets on an exchange, customers should consider a safer form of storage that will enable them to maintain their private keys (the "passwords" that verify ownership of crypto assets and authorize crypto transactions using that crypto). For example, a hardware wallet is a small "cold" storage device on which an investor can store crypto assets and that is connected to the internet only when effecting a crypto transaction. Not only does this type of device protect against bankruptcy risk, but it significantly reduces the risk of theft from hackers. Although certain risks are alleviated, there is a loss of convenience and risk of losing the wallet or private key, in which case the crypto may be impossible to recover.

Trust and Estate Considerations Relating to Crypto

As an asset class with a collective market cap of nearly $900 million (down from a nearly $3 trillion high in November 2021), crypto ownership gives rise to a number of traditional trust and estate issues as well, for both trustees and individuals. A few of those issues are discussed below.

Fiduciary Duty Considerations for Trustees

Given the volatility of the crypto marketplace and the bankruptcy risks identified above, trustees need to consider whether it is consistent with their fiduciary duties to invest in crypto assets at all. Many trustees will, as a matter of policy, determine that the answer is no, and that should be an acceptable answer.

However, if pressed by a beneficiary or otherwise to invest in crypto assets, trustees should carefully evaluate the nature of the proposed crypto asset investment. In evaluating the prudence of a crypto investment, it is important to understand that not all crypto assets are created equal. For example, while the prices of certain well-known crypto assets, including bitcoin, ethereum and certain popular "meme" coins, may fluctuate wildly, there is an entire class of crypto assets, called stablecoins, which are pegged to—and often backed by—fiat currency and which do not (or should not) fluctuate at all. Trustees should become familiar with the market for crypto assets and consider whether—if at all—a specific crypto investment is a suitable investment.

If trustees do determine to invest trust property in crypto assets, they also need to consider where and how to store the crypto assets securely. Not every trustee is sufficiently sophisticated to maintain crypto assets safely. As the market for crypto assets continues to grow, trustees will likely benefit from developing crypto-related capabilities or partnerships with trusted technology providers to enable the secure storage of crypto assets for their beneficiaries.

Succession Issues Relating to Crypto Assets

In order to access crypto assets not maintained on a centralized exchange, investors need to have access to both the wallet device on which the crypto assets are stored and the associated "private keys." If either is lost, then the crypto investment likely will also be lost forever.

For that reason, a plan needs to be put in place to ensure transfer to heirs of not only the hardware wallets or other storage devices but also instructions for accessing those devices, including accessing potentially encrypted private keys. As part of this plan, the private keys must remain confidential and secure during the investor's life. But a protocol also must be in place for heirs to know of the existence of the crypto assets and to access the hardware and the private keys upon death.

If the owner of crypto assets dies or becomes disabled without a plan in place for succession of those assets, the crypto assets will likely be lost. As of 2021, an estimated 20% of all bitcoins—worth more than $65 billion even at today's somewhat depressed prices—have been lost forever because of missing private keys, misplaced wallets or similar avoidable circumstances.

Using Volatility to Assist in Gifting and Planning

The volatility of crypto values can create opportunities for more typical divestiture of assets used in estate planning transactions, including contributions to trusts and charitable donations. For example, when the value of crypto assets is low, it might be wise to contribute those assets to a trust for family members, including grantor retained annuity trusts, which are most effective with volatile assets. When the prices rebound—and historically they have, and then some—that growth will occur outside the estate. Conversely, when prices are high, it might be appropriate to donate some of the coins to charity.

Despite the issues currently plaguing the industry, crypto, in some form or another, seems to be here to stay. In addition to understanding the inherent risk of investing in this volatile asset class, investors need to be careful to store their coins safely and in a way that minimizes exposure to the custodian's creditworthiness. Care must also be put into succession and estate tax planning. These issues are complex, and consultation with counsel and other trusted advisors (including technical advisors) is recommended.

Private Placement Life Insurance: An Overview

Private placement life insurance (PPLI) is a sophisticated life insurance product that offers death benefit protection while also providing access to a variety of registered and non-registered investments that are accessible solely within the life insurance policy structure. Interest in PPLI has risen recently because its unique features make it attractive during periods of increased tax uncertainty and market volatility. Those interested in planning with PPLI, however, should be aware that there are substantial financial thresholds, investment profiles and liquidity requirements that must be met. Ensuring the appropriateness of the planning for the individual and family as well as proper implementation and maintenance of the PPLI policy are also critical, particularly as the use of PPLI planning for high net worth families has recently come under scrutiny.

PPLI Defined

PPLI is a form of "permanent" variable universal life (or VUL) insurance providing both death benefit protection and a cash value component that accumulates investment growth within the policy. Premiums paid in excess of the cost for the death benefit coverage are credited to, and grow as part of, the policy's cash value. VUL policies enhance this investment feature by permitting policy owners to direct the allocation of the policy's cash value among various investment options managed by third-party advisers.

The key factor distinguishing PPLI policies from conventional VUL policies (those available to the general public) is the range of investment options. While insurance carriers provide limited investment choices for conventional VUL policies, with PPLI insurance, the policy owner can select from a wider array of investment options, including actively managed accounts, hedge funds (including "funds of funds") and alternative assets (for example, credit products, private equity, real estate funds, commodities, currencies and non-correlated investments). In addition, U.S. life insurance companies often limit the maximum amounts of coverage for their conventional life insurance policies, which may not offer sufficient death benefit protection for a high net worth family. PPLI policies can be designed to achieve the desired amount of death benefit coverage and provide these investment opportunities.

Planning Profile

PPLI insurance typically will not make sense for families focused solely on more traditional or guaranteed death benefit protection, since the future availability of death benefits is closely tied to the PPLI policy's investment performance. It tends to appeal to high net worth individuals who are insurable, have a desire or need for significant death benefit coverage and want the flexibility in investments offered in the policy to maintain that death benefit protection for the individual's family. Accordingly, most PPLI insurance purchasers meet the following profile:

- A net worth of $20 million or more, with significant liquid assets ($10 million or more) and annual income to cover expected and/or desired living expenses.
- The ability to fund at least $1 million (more likely, $3 million to $5 million) in annual premiums for several years (generally, aggregating more than $5 million in total investment) as well as additional costs for implementation and ongoing administration of the PPLI policy structure.
- A desire for significant investment in alternative asset classes, with an investment horizon generally of at least 10 – 15 years.
- Prior experience with the implementation and optimization of other estate planning strategies.

Features of PPLI Insurance

As with conventional variable universal life products, PPLI contracts are highly regulated and must comply with state insurance department regulations and qualify as "life insurance" under the Internal Revenue Code (IRC). Assuming they are treated as life insurance, the following apply to PPLI contracts:

Tax treatment. Currently, the tax rules generally applicable to life insurance contracts also apply to PPLI contracts, including:

- Investment earnings within the policy are not subject to tax as earned or realized.

- Cash values can be transferred between investments without taxation.
- Depending on the policy's structure, policy loans and withdrawals of cash value (up to the owner's tax basis in the policy—usually the premiums paid) are generally not subject to current income tax, unless the policy is a modified endowment contract (MEC), which is discussed below.
- Policy death benefits generally are not subject to income tax.

Investment options. Investment options can be customized based on the objectives of the policy owner, who may be able to add a particular investment manager to an insurance carrier's platform through the creation of an "insurance-dedicated fund" or "separate account" approved by the insurance company.

Flexibility. PPLI insurance offers flexibility on the timing and amount of premium payments and the amount of death benefit protection.

Customized cost structure. Typical costs associated with PPLI (as well as VUL) insurance products include commissions, mortality and expense charges, investment management fees and the cost of insurance protection (which can be higher relative to death benefit needs), although a lower overall cost structure often can be negotiated as part of the PPLI policy design. The federal deferred acquisition costs tax (up to 1% to 1.5% of premiums paid) and state premium taxes (from less than 1% to 3.5% of premiums paid) also apply to both PPLI and VUL products, although state premium taxes may be managed by selecting a lower (or zero) premium tax state in which to issue the policy.

Estate planning. As with conventional life insurance, holding a PPLI policy through a properly structured irrevocable life insurance trust may protect the policy proceeds from estate and generation-skipping transfer (GST) taxes.

Simplified tax reporting. K-1s are not required for alternative investments made through a PPLI policy.

Planning Considerations

Code requirements. PPLI insurance must satisfy several IRC requirements to qualify as life insurance and fall under the tax rules discussed above. In addition, certain limits apply to tax-free cash value withdrawals, generally in the first 15 years of a policy, so policy owners should anticipate a potentially extended horizon before making withdrawals.

MEC status. The favorable tax rules for policy loans and withdrawals will not apply if the PPLI policy is or becomes an MEC under the Code; generally, these are policies where most of the premiums are paid in the first four to seven years of the contract. If non-MEC status is desired, then premium payments for the PPLI policy must be carefully structured and monitored.

Investment risk. PPLI insurance does not provide any guaranteed return, leaving the policy owner with all the investment risk. At a minimum, the owner must pay enough premiums and/or the separate account investments must perform sufficiently to provide adequate cash value to cover the associated insurance costs or the policy will lapse, potentially generating adverse tax consequences.

SEC regulation. Since PPLI products are not registered under any securities laws, purchasers must meet the "accredited investor" and/or "qualified purchaser" requirements under applicable Securities and Exchange Commission (SEC) regulations. These regulations impose significant net worth and/or annual income thresholds, among other requirements, to ensure that the purchasers can demonstrate they have the business or financial experience needed to understand what they are buying and can tolerate the associated product risks.

Investor control. PPLI investment options must be offered only through the purchase of life insurance (i.e., not made available directly to the general public) and comply with the "investor control doctrine," which limits the policy owner's and/or the insured's control over the policy investments, including the following:

- There can be no arrangement, plan or agreement between the policyowner/insured and the investment adviser regarding the availability of specific investment strategies on the carrier-provided investment platform and/or the availability or selection of specific assets for investment.
- While the policy owner can choose among investment strategies made available on the insurance carrier's platform, neither the policy owner nor the insured can influence their execution or select or recommend particular investments or investment tactics.
- Other than the policy owner's right to allocate premiums among the carrier-provided investment options, the investment advisers (as selected and hired by the insurance company, in its sole discretion) have complete discretion over all investment decisions.

Diversification. The Code requires that the PPLI policy's separate account be adequately diversified. Generally, each separate account must contain at least five investments and meet other diversification tests, including that no more than 55% of the separate account may be represented by any one investment.

Premium funding. The funding of PPLI insurance involves significant premiums in the initial policy years (structured as needed to avoid MEC status) to help boost cash value performance and eventually allow cash value growth to cover the associated annual expenses and insurance costs. If an irrevocable trust owns the PPLI policy, premium funding will require careful planning to address gift taxes associated with premium contributions, as the required cumulative premiums can quickly exceed available federal gift and GST tax exemptions (currently set at $12.06 million).

Ongoing maintenance. PPLI insurance is not a "set it and forget" proposition. There are initial and ongoing expenses relative to the policy's design, implementation and maintenance, including for accountants, attorneys and other service providers who assist in the process.

Medical underwriting. PPLI insurance requires the insured to complete extensive financial and medical underwriting requirements to determine insurability.

Recent Scrutiny

In August and September, Sen. Ron Wyden, D-Ore., chair of the Senate Finance Committee, wrote letters to several life insurance companies that issue PPLI policies to gather information about the PPLI market. His letters stated that he is "conducting an investigation into the use of PPLI policies and other loopholes exploited by the wealthiest 1% of Americans to avoid paying their fair share in taxes." Wyden's investigation appears to be focused on tax policy and the potential for abuse in PPLI planning, which may have arisen primarily from the 2021 investigation into Swiss Life, a Swiss life insurance company. Swiss Life later pleaded guilty to using PPLI policies and related investment accounts to help U.S. taxpayers conceal ownership of assets offshore and evade paying U.S. taxes.

As the investigation is ongoing, it is not clear whether the Senate Finance Committee will take any action or whether any legislation will follow. Although Swiss Life is an example of an abuse, it involved a non-U.S. life insurance company that was hiding assets. PPLI policies issued by U.S. insurers are highly regulated, and both case law and the Code impose numerous requirements for PPLI policies to qualify as life insurance, which would address several of the concerns expressed by Sen. Wyden.

Bottom Line: PPLI Is Not For Everyone

In light of the ongoing tax and market uncertainty, PPLI is not for everyone. It is a complex life insurance product that requires financial sophistication and significant risk tolerance of the policy owner. For those who meet the requirements and are willing to undertake the proper implementation and administration, PPLI insurance may provide desired death benefit protection along with more investment flexibility in the policy to maintain that protection, but the trade-offs are the loss of investment control, various limitations on the timing and amount of access to cash values (even through policy loans) and potentially severe adverse tax consequences if the policy's parameters do not comply with the Code.

IRS Extends Deadline for Estates to Elect Portability of Tax Exemption

Thanks to the Internal Revenue Service's release of Rev. Proc. 2022-32 over the summer, married couples who are not otherwise required to file an estate tax return at the death of the first spouse now have substantially more time to make a portability election, permitting the transfer of the deceased spouse's unused federal estate tax exemption to the surviving spouse.

The Importance of Portability

Currently, each individual has a federal gift tax and estate tax exemption amount of $12,060,000 (in 2022). Any exemption amount not used for lifetime gifts remains available at death to offset federal estate taxes on the individual's taxable estate. Amounts left to a surviving spouse or to charity at one's death typically do not require the use of a decedent's remaining exemption amount because they qualify for the estate tax marital and charitable deductions. Before 2011, if a decedent left his or her entire estate to a surviving spouse, or if the value of the decedent's estate was lower than his or her remaining exemption amount, the tax benefit of any unused exemption was lost. To avoid this waste, typical estate planning for married couples involved creating a "bypass" or "credit shelter" trust to receive the deceased spouse's remaining exemption amount, which prevented those assets from being taxed again in the surviving spouse's estate.

In 2011, federal law changed to allow the transfer of a deceased spouse's unused exemption amount to the surviving spouse, enabling the survivor to apply the exemption amount "inherited" from the first spouse against lifetime gifts or to his or her estate at death. The intention was to protect married couples from the inadvertent waste of their exemption amounts by simplifying the planning needed to fully use both exemptions. If the exemption amount drops to $5 million per person (inflation adjusted), as it is scheduled to do in 2026, the importance of this portability election will increase as more families become exposed to potential federal estate tax.

How and When to Elect Portability

Any estate representative wanting to make a portability election for a deceased spouse's estate must file a federal estate tax return, regardless of whether a return would otherwise be due.

Estates over Filing Threshold. If the deceased spouse's estate is filing an estate tax return because the gross estate exceeds the filing requirement threshold (i.e., the gross estate, plus adjusted taxable gifts and specific exemptions, exceeds the decedent's exemption amount), the estate representative must make the portability election on the return, which is due nine months (or 15 months if an extension is obtained) after the date of the decedent's death.

Estates Filing for Portability Only. Unlike estates over the estate tax filing threshold, estates filing estate tax returns solely to make the portability election (a portability-only return) have far more time to file their returns after Rev. Proc. 2022-32. A portability-only return may now be filed anytime on or before the fifth anniversary of the decedent's death. The return must follow the simplified method for obtaining the extension as detailed in Rev. Proc. 2022-32, including a statement that the return is being "Filed Pursuant to Rev. Proc. 2022-32 to Elect Portability under Section 2010(c)(5)(A)."

This extended filing deadline is helpful for estates below the filing threshold, as those estate representatives may not understand the need to file a portability-only return or may not discover the need to elect portability for a surviving spouse until after the federal estate tax return due date. If, despite the extended time frame provided under Rev. Proc. 2022-32, an estate filing a portability-only return fails to file within the extension window, it is still possible for the estate representative to seek relief under Treasury Regulations Section 301.9100-3 to make the portability election. That process is much more complicated, however, as the taxpayer must pay a user fee and submit a private letter ruling request for relief to the IRS showing that the taxpayer acted reasonably and in good faith and that the granting of relief will not prejudice the government's interest.

Does Portability Eliminate the Need for Credit Shelter Planning?

While portability can prevent the loss of the first spouse's unused exemption, for many families, the benefits offered by credit shelter trust planning may outweigh the simplicity of relying on portability. When considering how to proceed, both tax and non-tax factors should be reviewed, including:

- A credit shelter trust will protect the appreciation on assets held in the trust from subsequent taxation in the surviving spouse's estate, while a portability election will not.
- Portability applies only to the federal exemption amount; most states with estate taxes, like New York, do not recognize portability. Married couples in those states who wish to make use of their state estate tax exemptions will still benefit from the use of credit shelter trusts.
- Portability also does not apply to the generation-skipping transfer (GST) tax exemption, which shields assets passing to grandchildren and later generations from GST tax. If there is a desire to create a long-term, multigenerational trust (a so-called dynasty trust), credit shelter planning can help preserve the deceased spouse's unused GST tax exemption.
- There is no post-death inflation adjustment of the exemption amount transferred to a surviving spouse via a portability election. Moreover, if the surviving spouse remarries and also survives his or her new spouse, any unused exemption received from the first predeceased spouse is lost.
- If the surviving spouse is ill or incapacitated, a credit shelter trust can provide ongoing asset management, although there also will be ongoing trust administration requirements and costs. In addition, to effectively use a credit shelter trust, a married couple may need to shift and retitle assets between them to ensure that each spouse individually owns assets equal to the exemption amount and that those assets do not automatically pass to the surviving spouse (as jointly held property with rights of survivorship or assets paid by beneficiary designation).
- Assets held in a credit shelter trust will not receive a step-up in income tax basis at the surviving spouse's death. Assets provided outright to, or in a marital deduction trust for, the surviving spouse, combined with a portability election, will permit a second step-up in basis for those assets at the surviving spouse's death and prevent the loss of any exemption.

Although portability provides some simplicity in planning and administration, it will often work better as a post-mortem "cleanup tool" for nonexistent or improperly implemented estate plans. The new extended deadline for filing a portability-only return also should provide welcome relief to advisors and executors of eligible estates, who now have a greater opportunity to make the election, if advantageous, without the cost and burdens of seeking a private letter ruling. As always, however, it is important for married couples to seek guidance from their estate planning attorney to determine whether credit shelter or other tax planning techniques might be better suited to their particular needs.

Vacation Home Not a Permanent Place of Abode for New York's Statutory Residence Rule

If you do not live in New York but have been considering a vacation home in the Empire State, you stand to benefit from the opinion in *Obus v. New York State Tax Appeals Tribunal*. Over the summer, a unanimous panel of justices of the Appellate Division of the New York Supreme Court delivered a taxpayer friendly ruling declaring that a vacation home in New York is not automatically deemed a "permanent place of abode" for purposes of New York's income tax residency rules and that the facts and circumstances surrounding the vacation home's use must be analyzed when applying New York's statutory resident test.

Determination of NY Resident Status

Under New York law, an individual can be deemed a New York resident in two ways:

- **Domicile Test:** The individual is domiciled in New York—that is, treats New York as the individual's permanent or "true" home.
- **Statutory Resident Test:** The individual is domiciled outside of New York but (a) maintains a "permanent place of abode" in New York and (b) spends more than 183 days of the year in New York. New York has traditionally maintained that a permanent place of abode is a residence or dwelling maintained by an individual that is suitable for year-round use. It does not matter if the individual owns or rents the home, and New York regulations have provided an explicit exception only for "a mere camp or cottage" for vacation use. Historically, this exception has not prevented New York from treating most vacation homes as permanent places of abode based solely on their physical characteristics.

Application to the *Obus* Case

Enter the taxpayers, Nelson Obus and his wife, Eve Coulson. Obus was a domiciliary of New Jersey but commuted daily to New York City for work. In 2011, the couple purchased a five-bedroom, three-bathroom vacation home in Northville, New York, some 200 miles north of New York City. The home had year-round climate control, and the taxpayers paid for all of the expenses for the property. Obus used the home for two to three weeks per year, primarily to partake in cross-country skiing or to visit the Saratoga race track in the summer. The home also included an attached apartment, which was occupied by a tenant whom Obus would always notify prior to his visits. Coulson used the home with even less frequency, having visited the home only twice after purchase.

For the years 2012 and 2013, the taxpayers filed joint nonresident income tax returns in New York, taking the position that they did not maintain living quarters in New York. These returns were audited and, in 2016, the New York Department of Taxation and Finance determined that the vacation home was a permanent place of abode, resulting in the classification of the taxpayers as New York statutory residents. The NYS Tax Department came to this conclusion as a result of the taxpayers having had the right to reside and maintain living arrangements in the Northville home with free and continuous access, determining that the taxpayers' infrequent use of the home was of no consequence. Accordingly, the NYS Tax Department issued a notice of deficiency, asserting an additional $526,868 of income tax, plus interest and penalties. The taxpayers sought a review with the NYS Division of Tax Appeals, but the review was denied, and they subsequently appealed to the Appellate Division.

Given Obus's daily commute, there was no question that he had spent 183 days in New York, satisfying the day-count prong of the statutory resident test. The sole issue for the Appellate Division was whether the home in Northville was properly classified as a "permanent place of abode" for purposes of determining statutory residency. The Appellate Division disagreed with the lower court and explained that for a vacation home to be treated as a permanent place of abode, the taxpayer must have a "residential interest" in the home by actually using the dwelling as a residence. Simply maintaining a vacation home that could potentially be classified as permanent place of abode does not make it so. The Appellate Division conceded that the Northville home was indeed much larger than a mere camp or cottage but determined that free and continuous access to the home was insufficient to categorize the home as a permanent place of abode. Not only did Obus use the home for only a few weeks per year, he could not possibly use the home to commute to his job in New York City as it was more than four hours away. Moreover, Obus regularly informed the apartment tenant when he would be visiting, and he did not keep personal effects at the home, choosing instead to bring with him what he needed on his visits. The Appellate Division concluded that, as Obus had not used the vacation home in a manner demonstrating a residential interest, he had not, in fact, maintained a permanent place of abode in New York. He therefore did not satisfy both components of the statutory resident test.

With the *Obus* ruling, a vacation home in New York no longer automatically qualifies as a permanent place of abode for purposes of the statutory resident test. Rather, this determination will require a closer fact-specific inquiry as to whether a taxpayer has a residential interest in the vacation home. At the very least, for now, it appears that a vacation home that is infrequently used, inconvenient for commuting and not otherwise used to store personal effects is not a permanent place of abode. While additional guidance would be desirable and may come in the future, in the interim, caution is still required when determining usage of a vacation home. A Manhattan pied-à-terre, for example, will not escape classification as a permanent place of abode if the taxpayer uses it regularly to commute to the office. And it is not clear how many visits to a "cozy cottage" in the Catskills will transform it from a mere cottage into a permanent place of abode. That said, *Obus* provides some direction for individuals in structuring the ownership and use of New York vacation homes while minimizing their potential classification as New York statutory residents.

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