IRS settles abusive insurance schemes

The IRS recently offered settlements to a select number of taxpayers involved in what are known as “micro-captive” insurance schemes.

Tax law generally allows businesses to create "captive" insurance companies to protect against certain risks.

In abusive “micro-captive” structures, accountants or wealth planners convince owners of closely held entities to engage in schemes that actually lack the protections of real insurance.

Under IRS Notice 2016-66, taxpayers are mandated to disclose such transactions due to their potential for tax evasion. Almost 80 percent of taxpayers offered the settlement accepted the offer.

The offers were made after the IRS won three cases in U.S. Tax Court cases fighting such schemes.

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Micro-captive schemes have been a major priority for IRS enforcement since 2014, and several active cases remain. Some will likely be settled and others will go to trial. The IRS plans to ramp up enforcement with teams auditing thousands of taxpayers.

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Final rules issued for ‘opportunity zones’

The Treasury Department recently issued final regulations regarding investments in so-called opportunity zones.

The Qualified Opportunity Zone program, which offers tax incentives for investing in economically blighted communities, was created under the 2017 Tax Cuts and Jobs Act.

Investment vehicles known as Opportunity Zone Funds allow investors to defer capital gains for up to 10 years, and possibly receive greater tax advantages, when they reinvest capital gains (from any investment, such as stocks, real estate or business interests) into census tracts designated opportunity zones. (There are 8,700 opportunity zones under the law.)

As of this year, opportunity-zone investments are no longer eligible for a 15 percent cost basis step-up, because the holding period will no longer be greater than seven years. (A requirement of opportunity zones is that the deferral gain be realized before the opportunity zone investment is sold or exchanged, or by Dec. 31, 2026, which is now less than seven years away.)

While the change might cool interest in the investments somewhat, the new regulations are positive for investors.

Opportunity Zone Funds have raised close to $4.5 billion to date, mostly in residential real estate, with a focus on large multifamily projects.

If you’re considered investing in opportunity zones, consult with an estate planning lawyer.

Some key points from the final rules:


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Investment of Section 1231 gains allowed. As defined by the Internal Revenue Service, Section 1231 property is real or depreciable business property that has been held for more than a year. A gain from the sale of such a property is taxed at the lower capital gains tax rate, instead of the rate for ordinary income.

The final rules allow for investment of gross gains on the sale of Section 1231 property, even for investors who have net losses. That means that an investor can invest the entire amount of capital gains, not just amounts that are greater than the losses.

Under the law, investors have 180 days to invest in an Opportunity Zone fund in order to defer their capital gains. According to

continued on page 2

Final rules issued for 'opportunity zones'

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the final regulations, if you are making a deferral election for a Section 1231 gain, the 180-day period begins on the date of the sale or exchange that gives rise to the gain.

Reduced length of vacancy period to allow for opportunity zone property. Proposed rules had required a five-year vacancy period for a property to qualify. Under the final regulations, the vacancy requirement is reduced to one year in some cases, and three years in others.

Option to sell single properties. A key change under the final regulations is that Qualified Opportunity Zone Funds can sell individual properties without having to sell the entire fund.

In certain cases, the final regulations allow a group of two or more buildings on the same parcel of land to be treated as a single property. In such cases, additions to the basis of the buildings are aggregated to determine whether the substantial improvement requirement is met. Therefore, a taxpayer is not required to increase the basis of each building by 100 percent as long as the total additions to the basis for the entire group of buildings equals 100 percent of the initial basis for the group of buildings.

The final regulations also make clear that, for the purposes of the substantial improvement test, the construction of a new building can contribute to the improvement of an opportunity zone property where an existing building is already present.

Foreign individuals and corporations can invest. Under the final rules, it is clear that nonresident foreign corporations and individuals are eligible to make opportunity zone investments with capital gains that are connected to a U.S. trade or business. That includes capital gains on real estate assets taxed to them under the Foreign Investment in Real Property Tax Act rules.

Working capital safe harbor created. When the proposed regulations were released, developers argued that they did not have enough time to complete a project. The final regulations extend the deadline from 31 months to 62 months.

Brownfield site development more attractive. The final rules allow developers to treat a brownfield site (meaning an industrial site that was once developed but is not currently in use) as meeting the original use requirement of the opportunity zone rules. This makes it more attractive to invest in developing a brownfield site. The rules also say that the land is considered significantly improved under the rules if contaminated land is remediated.

Generally speaking, the rules are beneficial for investors, but the rules could change again, and new reporting rules might be on the way.

Investments in "sin businesses" limited. The rules state that qualified opportunity zone businesses can invest a maximum of 5 percent in "sin businesses," defined as private or commercial golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other facilities used for gambling, and liquor stores.

Generally speaking, the rules are beneficial for investors, but the rules could change again, and new reporting rules might be on the way.

No tax on large gifts when exemption sunsets

Taxpayers making large gifts no longer have to worry about big taxes coming back to bite them years from now.

The IRS finalized regulations confirming that gifts made under the increased lifetime exemption under the Tax Cuts and Jobs Act of 2017 will not be subject to tax when the exemption returns to the rates that existed before the law went into effect (slated to occur on Jan. 1, 2026).

The TCJA temporarily increased the gift and estate tax exemption from $5 million to $10 million, with both amounts adjusted for inflation, beginning in 2018. The increase is scheduled to sunset at the end of 2025, which means that starting in 2026, the exemption is set to return to the prior amounts.

The law left an open question as to whether a gift made using the increased exemption would be taxed at death if the person died after the exemption sunsets.

For example, it was unclear how an estate would be taxed if a person made a gift of $8 million in 2020 and passed away in 2026, when the exemption amount is set to return to $5 million. Experts wondered if the amount of the gift that was over the exemption at the time of death (in this case, $3 million) would be subject to transfer taxes. This type of taxation is known as a "claw-back."

Under the newly finalized regulations, the taxpayer who made the $8 million gift would not have to pay transfer taxes on the $3 million. The regulations say that in 2026, such a taxpayer's basic exclusion amount at death is either 1) the basic exclusion amount used when the exclusion amount was increased under the TCJA period, or 2) the basic exclusion amount available to the taxpayer at death, whichever is greater.

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New rules for required minimum distributions

The amount of time banks and other financial institutions have to notify people with retirement accounts about new rules for taking required minimum distributions (RMDs) has been extended.

Under IRS Notice 2020-06, financial institutions have until April 15 to notify certain people with retirement accounts that no RMD is due for 2020. The new rule was recently enacted under the SECURE Act, increasing the age for RMDs from 70 1/2 to 72.

Before passage of the SECURE Act, financial institutions had until Jan. 31 to inform IRA owners who would turn 70 1/2 in 2020 about the RMD for this year.

For institutions that sent letters to IRA owners with incorrect information, corrected letters must be sent by April 15.

The relief was necessary for institutions that did not have enough time to change their systems after the SECURE Act went into effect at the end of 2019.

RMDs are important to know if you're over 70, or if you manage the finances of a family member who is, because you must take the required payout on the timeline set out by the IRS or face a penalty equal to 50 percent of the amount you were supposed to take out.

Typically, plan administrators send reminders to IRA owners in January.

Under the SECURE Act, the new beginning date for an IRA owner to take an RMD is April 1 of the calendar year that follows the calendar year in which the individual turned 72, rather than 70 1/2.

If the following scenarios match your circumstances, here's what you need to do:

I turned 70 1/2 in 2019 and have not yet taken my RMD for 2019. You must take your 2019 RMD by April 1. The amount you are required to take depends on your account balance as of Dec. 31, 2018. In addition, you are required to take an RMD for 2020 by Dec. 31. The amount of that RMD is based on your retirement account balance as of Dec. 31.

I turn 70 1/2 in 2020. You have no RMD for 2020 and do not need to take any action.

I turn 70 1/2 in 2020 and I was so prepared that I already took my RMD for 2020, either in total or in part. As of December, the IRS and the Treasury Department were still evaluating what to do in this situation. Contact your estate planning lawyer for the latest updates.