Proskauer

Wealth Management Update

March 2025

March 2025 AFRs and 7520 Rate

The March 2025 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.40%, which was the same as the February 2025 rate. The March applicable federal rate ("AFR") for use with a sale to a defective grantor trust or intra-family loan with a note having a duration of:

- 3 years or less (the short-term rate, compounded annually) is 4.31%, down from 4.34% in February;
- 3 to 9 years (the mid-term rate, compounded annually) is 4.46%, down from 4.52% in February; and
- 9 years or more (the long-term rate, compounded annually) is 4.82%, down from 4.86% in February.

Seabrook Property, LLC v. Commissioner (TC Memo 2025-6)

Facts: Seabrook Property, LLC ("Seabrook") owned a large parcel of land in Liberty County, Georgia, a largely rural county. The land was mostly undeveloped and located near the Georgia coast. In 2017, Seabrook entered into an agreement with the Southern Conservation Trust, Inc., a qualified 501(c)(3) charitable organization, to grant a perpetual conservation easement on the property.

Before the easement donation, an Option Agreement was made to provide InvestCo, a company established to facilitate the transactions related to the easement donation, an opportunity to acquire the entirety of Ms. Belford, a 97% member of Seabrook's interest in Seabrook for $4.74 million. In December 2017, InvestCo exercised its option and acquired Ms. Belford's 97% interest in Seabrook.

Seabrook obtained an appraisal to establish the value of the conservation easement it was donating. Based on this valuation, Seabrook claimed a noncash charitable contribution deduction of $32,581,443 on its tax return for 2017. The IRS audited Seabrook’s tax return and ultimately disallowed the entire charitable deduction. The IRS’s reasoning was that Seabrook engaged in the transaction to provide tax benefits to its members, not to engage in any charitable giving. Additionally, the IRS determined that Seabrook was subject to accuracy-related penalties and penalties for participation in a reportable transaction under § 6662A. Seabrook argued that the charitable contribution deduction was valid because the easement was donated to a qualified organization, and the deduction was based on a credible appraisal.

Analysis: Three key issues were presented before the Tax Court: (i) Whether Seabrook and its members had the requisite donative intent when donating the easement; (ii) the value of the easement; and (3) whether an accuracy-related penalty, which is 20% of the portion of the underpayment of tax, applies under § 6662.

The Tax Court rejected the IRS’s argument that Seabrook lacked donative intent and cited previous cases stating that the objective fact that a perpetual conservation easement was donated to a charitable organization defeated the IRS’s contention as to the donor’s subjective intent and that tax benefits associated with a charitable contribution deduction are not a “quid pro quo” that negates the donor’s charitable intent.

The Tax Court, in considering the facts, focused on the appropriateness of the appraisal and the valuation methodology. Because there is not a substantial record of sales of comparable easements, the Court noted that the easement would be valued by calculating the fair market value of the easement property before and after the easement was granted. In determining the “before value,” the Court stated that the appraiser must consider not only the actual use of the easement property but also its highest and best use. Seabrook claimed that the highest and best use of the property was a master-planned residential development, to which the Court agreed. In addition, the Court used the comparable sales approach to value the property before the easement because the comparable sales approach is “generally the most reliable method of valuation for vacant, unimproved property.” In using that approach, the Court rejected Seabrook’s appraiser’s method in comparing the property to the lands that span a vast area of the southeast, including a densely populated area 30 minutes from Disney World. The Court also rejected the income approach and discounted cash flow analysis, due to unreliable inputs and speculative assumptions. Lastly, the Court considered the actual transaction in which Ms. Belford sold her 97% interest in Seabrook to InvestCo for $4.74 million as an indicator of the value of the property.

Holding: In conclusion, the Tax Court determined that the correct value of the easement in late 2017 was no greater than $4,718,000, which is less than one-seventh of what Seabrook claimed. The Court arrived at this figure by averaging the adjusted values of three comparable sales from the IRS’s expert and by taking the price Ms. Belford received for her interest in Seabrook into consideration. Due to the gross valuation misstatement, the Court imposed a 40% gross valuation misstatement penalty on the portion of the underpayment attributable to the overvaluation under §§ 6662(a), (b)(3) and (e)(1)(A).

IRS Announcement 2025-2

Announcement 2025-2, issued by the IRS, provides an update on the applicability dates of certain regulations concerning Required Minimum Distributions (“RMDs”) under § 401(a)(9).

On February 24, 2022, the Treasury Department released proposed regulations addressing RMDs, reflecting changes introduced by the Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE Act”). On December 29, 2022, the SECURE 2.0 Act was enacted, introducing further modifications to RMD rules. On July 19, 2024, in response to the SECURE 2.0 Act, the Treasury Department and the IRS published both final and proposed regulations regarding RMDs. The proposed regulations were intended to apply to distributions starting January 1, 2025.

After the final and proposed regulations were published, the Treasury Department received concerns regarding the challenges of implementing these regulations before the effective date of January 1, 2025. In response to concerns raised by commenters, the provisions of future final regulations amending § 1.401(a)(9)-4 (Determination of the designated beneficiary), §1.401(a)(9)-5 (Required minimum distributions from defined contribution plans), and §1.401(a)(9)-6 (Required minimum distributions for defined benefit plans and annuity contracts) to be issued under the 2024 proposed regulations are anticipated to apply beginning on January 1, 2026. This delay is intended to provide taxpayers and plan administrators additional time to understand and implement the new requirements. Until the new regulations become applicable, taxpayers are expected to operate under a reasonable, good-faith interpretation of the existing statutory provisions related to RMDs.

Private Letter Ruling 202504007 (January 31, 2025)

Subsequent to the decedent’s death, a Marital Trust was created with the surviving spouse as the primary beneficiary. The Marital Trust is a qualified terminable interest property trust. The trustees plan to divide the Marital Trust into two separate trusts, Trust 1 and Trust 2, on a non-pro rata basis. Both trusts will have terms identical to the original Marital Trust, including provisions for distributions to designated beneficiaries upon the surviving spouse’s death. After the division, the surviving spouse intends to disclaim all her interests in Trust 1.

The IRS concluded that the division would not cause the Marital Trust, Trust 1, Trust 2, or any beneficiary to recognize ordinary income or loss, or capital gain or loss. This is because the division is authorized under the trust’s terms, and the non-pro rata funding of the new trusts is consistent with the criterion set forth in § 1.1001-1(h)(1)(ii) for an exchange of property not materially different in kind or in extent.

In addition, the IRS noted that Trust 1 and Trust 2 would continue to be qualified terminable interest property trusts because, after the division, the surviving spouse would continue to be entitled to all the income from the property and, no person, other than the surviving spouse, will have a power of appointment over any part of Trust 1 and Trust 2.

Moreover, upon making a non-qualified disclaimer of her interest in Trust 1, the surviving spouse would be treated as having made a gift of her qualifying income interest under §2511 and a gift of all other interests in Trust 1 under § 2519. The IRS further concluded that the disclaimer would not cause any property in Trust 2 to be treated as a gift by the surviving spouse under § 2519, as the disclaimer pertains solely to Trust 1.

Lastly, the IRS determined that the value of the property in Trust 1 would not be included in the surviving spouse's gross estate under § 2044(a) because § 2044(b)(2) excludes such property from the gross estate when it has been previously treated as a gift under § 2519.

Chief Counsel Memorandum 202504014

Facts: The Foundation was incorporated in State 1 and recognized by the IRS as a private nonoperating foundation. It was initially funded with stock by Foundation Manager 1 and Foundation Manager 2, who are spouses. These two individuals have served as the sole members of the Foundation's board and as its only officers since Year 1 (hereinafter referred as "Foundation Manager 1" and "Foundation Manager 2"). Investment decisions, including loans, were primarily made by Foundation Manager 1.

Foundation Manager 1 established Company 1 in State 1, serving in key leadership roles. In Year 7, Foundation Manager 1 owned more than 35% of Company 1's voting stock, though this ownership percentage decreased in subsequent years. The Foundation extended multiple unsecured balloon loans to Company 1. Company 1 paid interest quarterly.

Foundation Manager 1 established Company 2 in State 2. Prior to Year 13, Foundation Manager 1 held a C% profits interest in Company 2 and served in a leadership role. In Year 13, Foundation Manager 1 and Foundation Manager 2 acquired full ownership of Company 2. Company 2 received loans from the Foundation each year between Year 3 and Year 12 and failed to make interest payments on some of these loans.

The loans to both Company 1 and Company 2 made up a substantial portion of the Foundation's assets. Extensions on the loans were granted in multiple years, with Foundation Manager 1 signing the extension letters on behalf of both the Foundation and the companies. The Foundation did not keep board meeting minutes reflecting the approval of the loans.

In Year 13, Foundation Manager 1 wanted to purchase all of the remaining equity in Company 2. To remove the Company 2 loans from the Foundation's books in order to resolve any potential violation of self-dealing rules, the Foundation's tax preparer proposed that the Foundation grant the Company 2 notes to public charities at a zero-dollar value. Although the tax preparer reported the transfers of Company 2 notes on the Foundation's Year 13 tax return, the notes were never actually transferred. The Foundation conceded that an act of self-dealing occurred with respect to the Company 2 notes in Year 13 and proposed to correct this by transferring the notes to public charities. The Foundation and Company 2 also modified the notes in Year 13, extending the repayment period and reducing the interest rate significantly.

Analysis:

- **Issue 1: Private Benefit.** Citing § 501(c)(3) and relevant regulations and case law, the Memorandum concluded that the Foundation's tax-exempt status should be revoked. Even though the Foundation made over $L in grants to charitable organizations,the Foundation's activities, i.e. making unsecured loans to business entities founded, operated, and partially owned by a foundation manager, primarily benefited the Foundation Manager 1 and his businesses, causing it to operate for a significant non-charitable purpose rather than public interests.
- **Issue 2: Indirect Self-dealing.** The Memorandum concluded that the loans in this case constituted the use of the Foundation assets for the benefit of a disqualified person, and therefore, constituted indirect acts of self-dealing under Section § 4941.
- **Issue 3: Correction of the Company 2 Loan Transactions.** The Memorandum concluded that the Foundation's proposed transfer of the Company 2 promissory notes to public charities is insufficient to constitute a correction of a self-dealing transaction under 4941(e)(3). To correct a self-dealing transaction, the act of self-dealing has to undo the transaction with a private foundation to the extent possible, which includes terminating the use of such property in the transaction. Here, in order to correct

the self-dealing transactions, the loans must be repaid, as the correction requires termination of the use of foundation property.

- **Issue 4: Jeopardizing Investments.** The Company 2 notes were considered investments of the Foundation, and the extension thereof was considered to have made a new investment under Treas. Reg. § 53.4944-1(a)(2)(iii). The Memorandum concluded the Year 13 loan modifications constituted jeopardizing investments under § 4944. Factors contributing to the conclusion are as follows: (i) the extension of the loans did not call for security or collateral despite Company 2’s records of failing to pay interest over the years; (ii) the significant reduction in interest rate and the extension of the loan term were not documented and are to the detriment of the Foundation; (iii) the modification of the notes was not subject to independent review despite the conflict of interest between Company 2, which was fully owned by Foundation Manager 1 and Foundation Manager 2, and the Foundation; and (iv) Foundation Manager 1’s failure to exercise ordinary business care and prudence in agreeing to the loan modifications.

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