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Suspicious activity reporting requirements for investment advisors

The Financial Crimes Enforcement Network (FinCEN) has released a proposed rule that would include certain at-risk investment advisors in the definition of financial institution under the Bank Secrecy Act (BSA), prescribe minimum standards for those advisors to establish programs to prevent money laundering and the financing of terrorism, and require them to report suspicious activity to FinCEN.

FinCEN's proposed rule would address gaps in the existing anti-money laundering/countering the financing of terrorism (AML/CFT) regulatory framework and prescribe minimum standards in the investment advisor industry (RIN 1506-AB58, Feb. 15, 2024, 89 FR 12108). The proposed rule would apply to investment advisors who might be at risk for misuse by money launderers, terrorist financiers or other actors who seek access to the U.S. financial system for illicit purposes and thereby threaten U.S. national security. Currently, the definition of financial institution does not cover registered investment advisors (RIAs) or exempt reporting advisors (ERAs), and as a result, RIAs and ERAs generally have been exempt from most AML program requirements under U.S. law.

The proposed rule builds on the 2021 *U.S. Strategy on Countering Corruption*, which recommended that the Treasury

Department assess the risks posed by the investment advisor industry. According to the fact sheet issued concurrently with the proposed rule, this risk assessment identified various illicit finance and national security risks. The Treasury Department found a variety of cases in which sanctioned individuals, corrupt officials, tax evaders and other criminal actors used investment advisors as an entry point to invest in U.S. securities, real estate and other assets. The risk assessment also identified cases of foreign adversaries (including Russia and China) acting through investment advisors to invest in start-ups and early-stage companies as a means of accessing sensitive information and emerging technology.

Under the proposed rule, those investment advisors deemed at-risk would be classified as financial institutions under the BSA. This would apply to RIAs, who are registered or required to register with the U.S. Securities and Exchange Commission (SEC), and to investment advisors who report to the SEC as ERAs under the Investment Advisers Act of 1940. Investment advisors generally must register with the SEC if they have over $110 million in assets under management (AUM). ERAs are investment advisors who advise only private funds and have less than $150 million in AUM in the United States, or who advise only venture capital funds. ERAs are exempt from SEC registration but still must file certain information with the SEC.

The proposed rule would require RIAs and ERAs to:

- Develop and implement risk-based AML/CFT policies and programs, including designation of an AML/CFT compliance office and implementation of appropriate employee training
- File suspicious activity reports (SARs) and currency transaction reports (CTRs) with FinCEN
- Keep records relating to the transmittal of funds (the record-keeping and travel rule under the BSA)
- Fulfill any other obligations of financial institutions subject to the BSA and specified in FinCEN's implementing regulations

The proposed rule would also apply information sharing provisions between and among FinCEN, law enforcement government agencies and certain financial institutions, and would subject investment advisors to the special measures imposed by FinCEN under section 311 of the USA PATRIOT Act (31 USC §5318A). In addition, FinCEN is proposing to delegate examination authority for this rule to the SEC, given the SEC's expertise in regulation of investment advisors and examining AML/CFT responsibilities of other financial institutions.

Covered investment advisors would be required to comply with the rule within 12 months after the rule is finalized.

As part of this proposal, FinCEN is withdrawing a 2015 proposed rule that would have applied AML program, SAR filing and other AML/CFT requirements to RIAs (RIN 1506-AB10, Aug. 24, 2015, 80 FR 52680). The Treasury Department determined the investment advisor sector has nearly doubled in AUM since the issuance of the 2015 NPRM (RIN 1506-AB10, Aug. 24, 2015, 80 FR 52680), and the rapid growth of this sector emphasized the need to strengthen the applicable regulations. ■

Retirement communities managed by REIT did not qualify as health care facilities

Independent retirement living communities managed by a corporation that elected to be taxed as a real estate investment trust (REIT) did not meet the definition of health care facilities under Code Sec. 856(e)(6)(D)(ii) (IRS Letter Ruling 202415001). While the communities offered some services found in congregate care health care facilities, the emphasis of the amenities and services provided at the managed communities was not the health and well-being of the residents.

However, one of the taxpayer's properties met the definition of congregate care facility under Code Sec. 856(e)(6)(D)(ii) and therefore constituted a qualified health care property under Code Sec. 856(e)(6)(D)(i). The property's compliance with state health care regulations, such as initial and periodic health screening, active management in procuring health care services required by residents and provision of such services through a licensed health care provider pursuant to a written agreement caused the property to emphasize its residents' health and well-being. ■

Proposed regulations provide guidance for excise tax on stock repurchases

The IRS has issued proposed regulations providing guidance on the application of the new excise tax on repurchases of corporate stock made after Dec. 31, 2022 (NPRM REG-115710-22).

Code Sec. 4501

Beginning in 2023, Code Sec. 4501 subjects a covered corporation to an excise tax equal to 1% of the fair market value of its stock repurchased by the corporation during the tax year. A covered corporation for this purpose is any domestic corporation whose stock is traded on an established securities market.

Repurchase includes stock redemptions and economically similar transactions as determined by the IRS. The amount of repurchase subject to the tax is reduced by the value of new stock issued to the public or employees during the year. Repurchase of the covered corporation's stock by its specified affiliate (a more than 50% owned domestic subsidiary or partnership) also subjects the covered corporation to the excise tax.

The excise tax does not apply if the stock repurchases during the year total less than $1 million and in certain other situations.

Proposed operative rules under Code Sec. 4501

The proposed regulations would provide general rules regarding the application and computation of the stock repurchase excise tax, statutory exceptions and application of Code Sec. 4501(d). Specifically, the proposed regulations would provide guidance addressing the following:

- Certain issues related to the effective date and transition relief, including:
  - Repurchases before Jan. 1, 2023, are not taken into account for purposes of applying the *de minimis* exception.
  - A covered corporation with a tax year that both begins before Jan. 1, 2023, and ends after Dec. 31, 2022, may apply the netting rule to reduce the fair market value of its repurchases during that tax year by the fair market value of all issuances of its stock during the entirety of that tax year.
  - Contributions to an employer-sponsored retirement plan during the 2022 portion of a tax year beginning before Jan. 1, 2023, and ending after Dec. 31, 2022, should be taken into account for purposes of Code Sec. 4501(e)(2).
  - The date of repurchase for a regular-way sale of stock on an established securities market is the trade date.
- Definition of stock and the application of the excise tax to various types of stock, options and financial instruments: The proposed regulations generally would maintain the definition of stock from Notice 2023-2 but would exclude additional tier 1 preferred stock. Therefore, unless the limited-scope exception regarding additional tier 1 preferred stock applies, the stock repurchase excise tax would apply to preferred stock in the same manner as common stock.
- Rules for valuation of stock: Generally, the proposed regulations would adopt Notice 2023-2's valuation approach that the fair market value of stock repurchased or issued is the market price of the stock on the date the stock is repurchased or issued, respectively.
- Rules for timing of issuances and repurchases: The approach that stock generally should be treated as repurchased when tax ownership of the stock transfers to the covered corporation or to the specified affiliate would generally be retained.
- Rules regarding becoming or ceasing to be a covered corporation and determining specified affiliate status.
- Rules regarding Code Sec. 301 distributions and complete/partial liquidations.
- Treatment of taxable transactions, including LBOs and other taxable "take private" transactions.
- Treatment of Code Sec. 304 transactions, reorganizations and Code Sec. 355 transactions.
- Application of the statutory exceptions, including repurchase as part of a reorganization, contributions to employer-sponsored retirement plans, the *de minimis* exception, repurchases by dealers in securities, repurchases by RICs and REITs, and the dividend exception.
- Application of the netting rule (the adjustment for stock issued by a covered corporation, including stock issued or provided to employees of a covered corporation or its specified affiliate).
- Considerations for mergers and acquisitions with post-closing price adjustments and troubled companies.
- Application of Code Sec. 4501(d).

Final rules amend definition of short-term, limited-duration insurance

The IRS, in connection with other agencies, has issued final rules amending the definition of short-term, limited-duration insurance (STLDI) and adding a notice requirement to fixed indemnity excepted benefits coverage in an effort to better distinguish the two from comprehensive coverage (T.D. 9990).

Comprehensive coverage is health insurance subject to certain federal consumer protections. Both STLDI and fixed indemnity excepted benefits coverage generally provide limited benefits at lower premiums than comprehensive coverage, and enrollment is typically available anytime rather than restricted to open and special enrollment periods. However, the government is concerned about financial and health risks consumers face if they use either form of coverage as a substitute for comprehensive coverage, particularly a long-term substitute. Consumers who do not understand key differences between STLDI, fixed indemnity excepted benefits coverage and comprehensive coverage may unknowingly take on significant risks if they purchase STLDI or fixed indemnity excepted benefits coverage under the misunderstanding that such products provide comprehensive coverage.

Definition of STLDI

STLDI is a type of health insurance coverage primarily designed to fill temporary gaps in coverage that may occur when an individual is transitioning from one plan or coverage to another (for example, due to application of a waiting period for employer coverage). Because STLDI falls outside individual health insurance coverage, it is generally exempt from the federal individual market consumer protections and requirements for comprehensive coverage. This can be an issue because individuals who enroll in STLDI are often not aware they will not be guaranteed these key protections.

> "Like other forms of excepted benefits, fixed indemnity excepted benefits coverage does not provide comprehensive coverage."

Under the definition in the final rules, STLDI is health insurance coverage provided pursuant to a policy, certificate or contract of insurance with an expiration date no more than three months after the original effective date and a total duration no longer than four months, taking into account any renewals or extensions. For purposes of this definition, a renewal or extension includes the term of a new STLDI policy, certificate or contract of insurance issued by the same issuer to the same policyholder within the 12-month period beginning on the original effective date of the initial policy, certificate or contract of insurance.

STLDI issuers must display a notice in at least 14-point font on the first page (either paper or electronic, including on a website) of the policy, certificate or contract of insurance, and in any marketing, application and enrollment materials (including reenrollment) provided to individuals at or before the time an individual has the opportunity to enroll or re-enroll in the coverage. A sample notice has been provided by the agencies.

Fixed indemnity insurance

Federal consumer protections and requirements for comprehensive coverage do not apply to any individual coverage or group health plan in relation to its provision of certain types of benefits known as excepted benefits. Like other forms of excepted benefits, fixed indemnity excepted benefits coverage does not provide comprehensive coverage. Rather, its primary purpose is to provide income replacement benefits. Benefits under this type of coverage are paid in a fixed cash amount following a health-related event, such as a period of hospitalization or illness. In addition, benefits are provided at a pre-determined level regardless of any health care costs incurred by a covered individual with respect to the health-related event. Although a benefit payment may equal all or a portion of the cost of care related to an event, it is not necessarily designed to do so.

To give consumers an informed choice, the final rules require a consumer notice that must be provided when offering fixed indemnity excepted benefits coverage in the group market and update the existing notice for such coverage offered in the individual market. The final rule does not address any other provision of the 2023 proposed rules (NPRM REG-120730-21) relating to fixed indemnity excepted benefits coverage.

IRS extends transition relief for required minimum distributions in 2024

The IRS announced that final regulations related to required minimum distributions (RMDs) under Code Sec. 401(a)(9) will apply no earlier than the 2025 distribution calendar year (Notice 2024-35). The IRS also provided transition relief for 2024 for certain distributions made to designated beneficiaries under the 10-year rule. The transition relief extends similar relief granted in 2021, 2022 and 2023.

SECURE Act changes

The SECURE Act of 2019 (P.L. 116-94) changed the RMD rules for employees and IRA owners who died after Dec. 31, 2019. Under Code Sec. 401(a)(9)(H)(i), if an employee in a defined contribution plan or IRA owner has a designated beneficiary, the five-year distribution period has been lengthened to 10 years, and the 10-year rule applies regardless of whether the employee dies before the required beginning date. Proposed regulations would interpret the 10-year rule to require the beneficiary of an employee who died after their required beginning date to continue to take an annual RMD beginning in the first calendar year after the employee's death. This aspect of the 10-year rule differs from the five-year rule, which required no RMD until the end of the five-year period. Thus, the IRS provided transition relief for 2021, 2022 and 2023.

Guidance for specified RMDs for 2024

Under the transition guidance, a defined contribution plan will not be treated as having failed to satisfy Code Sec. 401(a)(9) for not making an RMD in 2024 that would have been required under the proposed regulations. The relief also applies to an individual who would have been liable for an excise tax under Code Sec. 4974. The guidance applies to any distribution that, under the interpretation included in the proposed regulations, would be required under Code Sec. 401(a)(9) in 2024 under a defined contribution plan or IRA subject to the rules of Code Sec. 401(a)(9)(H) for the year in which the employee (or designated beneficiary) died, if that payment would be required to be made to:

- A designated beneficiary of an employee or IRA owner under the plan if the employee or IRA owner died in 2020, 2021, 2022 or 2023, on or after the employee's (or IRA owner's) required beginning date, and if the designated beneficiary is not using the lifetime or life expectancy payments exception under Code Sec. 401(a)(9)(B)(iii)
- A beneficiary of an eligible designated beneficiary if the eligible designated beneficiary died in 2020, 2021, 2022 or 2023, and was using the lifetime or life expectancy payments exception under Code Sec. 401(a)(9)(B)(iii)

Applicability date of final regulations

The IRS has announced the final regulations regarding RMDs under Code Sec. 401(a)(9) and related provisions are anticipated to apply for determining RMDs for calendar years beginning on or after Jan. 1, 2025. ■

Tax treatment of rebates for energy-efficient property and improvements

The IRS has issued an announcement that addresses the federal income tax treatment of amounts paid for the purchase of energy-efficient property and improvements (Announcement 2024-19, IR-2024-97). Taxpayers who receive rebates for the purchase of energy-efficient homes are not required to include the value of those rebates as income on their tax returns. However, when they sell the property, they would need to reduce its basis by the amount of the rebate.

The Inflation Reduction Act (IRA) describes performance-based incentives and electrification product subsidies as rebates. The IRS has announced that amounts received from the Department of Energy home energy rebate programs funded through the IRA will be treated as a reduction in the purchase price or cost of property for eligible upgrades and projects. Accordingly, a consumer receiving an IRA rebate would not be required to report the value of the rebate as income. ■

Treatment of taxable distributions from donor-advised funds clarified

The U.S. Department of Treasury and the IRS have released the first installment of proposed guidance relating to donor-advised funds (DAFs). The proposed regulations expand on earlier guidance, clarifying the scope of accounts treated as DAFs and what constitutes taxable distributions. Future guidance is expected to further address prohibited transactions.

The Treasury and IRS have issued proposed regulations regarding the application of excise taxes under Code Sec. 4966 to taxable distributions from DAFs, as well as guidance regarding agreements by certain fund managers to make such distributions (NPRM REG-142338-07). The proposed regulations would apply generally to community foundations and similar organizations maintaining DAFs, and to the individuals involved with the DAFs, including donors, their advisors, related persons and certain fund managers.

The proposed regulations would clarify the definition of a DAF (under Code Sec. 4966(d)(2)(A)) as any fund or account that:

- Is separately identified by reference to the contributions of donors
- Owned and controlled by a sponsoring organization
- Has at least one donor (or donor-advisor) who reasonably expects advisory privileges regarding distributions or investment of assets held in the fund simply due to being a donor

> "If a donor-advisor delegates any advisory privileges to another person, that person would also be a donor-advisor."

The proposed regulations would presume that advisory privileges of a donor or donor-advisor arise because of the donor's status as a donor, except where specifically provided otherwise. If a fund or account meets all three elements of this test, it would be considered a DAF except as specified otherwise in Code Sec. 4966(d)(2).

The proposed regulations provide a six-category list of facts and circumstances relevant in determining that a fund or account is separately identified (as defined by Code Sec. 4966(d)(2)(A)(i)). The proposed regulations would also provide four special rules relating to advisory privileges, each based on the presumable basis for the advisory privileges:

- Donor or donor-advisor
- Service on an advisory committee
- Status as a director, officer or employee of a sponsoring organization
- Sole person with advisory privileges for a fund or account

The proposed regulations would define a donor-advisor as a person designated by a donor to have advisory privileges for the distribution or investment of assets held in a fund or account of a sponsoring organization. If a donor-advisor delegates any advisory privileges to another person, that person would also be a donor-advisor. Three special rules regarding donor-advisors are also proposed. In addition, special rules would apply to the advisory committees of sponsoring organizations.

The proposed regulations generally would provide exceptions from being defined as a DAF for any fund or account that makes distributions only to a single identified organization or certain grants to individuals for travel, study or other similar purposes. Additionally, the IRS has discretionary authority to exempt a fund or account from the definition of DAF for certain disaster relief funds and certain scholarship funds whose committee is nominated by a Code Sec. 501(c)(4) organization with a broad-based membership.

Edward Jones tax management opportunities

Although Edward Jones cannot provide tax or legal advice, our financial advisors can use a team approach with you to help mutual clients understand the impact of capital gains and losses on their investments and offer opportunities to use tax management strategies before the end of 2024.

1. Financial advisors can **identify clients** who may have substantial realized gains and/or losses before the end of 2024 and get permission to share this information with you.
2. They can **identify current investments** these clients hold at Edward Jones that may have substantial unrealized capital gains and/or losses.
3. They can work together with you to **share tax management opportunities** with these clients.

Learn more

Please contact one of our financial advisors today about helping mutual clients.

Building a team of professionals to help provide solutions for our clients

At Edward Jones, we believe that when it comes to financial matters, the value of professional advice cannot be overestimated. In fact, in most situations we recommend that clients assemble a team of professionals to provide guidance regarding their financial affairs: an attorney, a tax professional and a financial advisor.

We want to work together as a team and offer value for your practice and clients. Using complementary skills and philosophies, we can help save time, money and resources while assisting mutual clients in planning for today's financial and tax challenges.

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