



■ Shenkman

PRACTICAL PLANNER®

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DISCOUNTS DISAPPEARING; HILLARY VS. DONALD

Summary: I might be the “little estate planner who cried wolf” just like in 2012, but for you it might be a classic “you snooze you lose tax benefits.” Although it remains uncertain what the final Regs will do, or when they will be effective, waiting could be dangerous. Grrrrr says the tax wolf. Plan now because the IRS may have bigger teeth in the future. Cautious taxpayers might act now to steer around the imminent 2704 limitations, and the possibility of more severe tax restrictions if Hillary wins.

■ **2704 Regs:** No these aren’t bingo numbers. It’s a Proposed Regulation that could unravel your fav estate tax planning elixir, discounts. The Treasury Department has proposed regulations that may zap valuation discounts. Your business might be worth \$10M, but 40% might not be worth the pro-rata \$4M, instead perhaps \$2.5M because it is a non-controlling slice. That valuation haircut makes some estate planning strategies hum. Absent discounts some strategies just don’t work well, others might not work at all. What this means is that many (not all) wealthy taxpayers could lose significant planning options if they don’t implement planning before year end when those new regs might become effective. Find out if you really need discounts or if they will substantially goose-up your tax bennies. If the answer is affirmative, hug your estate planners.

■ **Tweak Techniques:** Planning should reflect the unique current tax environment, not merely copy-cat the stuff you might have done in 2012. Discount preservation is the focus. Interest rates are low, making sales of assets and use of GRATs pretty powerful. Short term rolling (cascading) GRATs have been the rage, but if Hillary wins and Bern’s this technique, you’ll regret not having used longer term GRATs. Alas, longer term GRATs present different planning issues. Mortality risk is a biggie. If you die during the term of the GRAT you might receive little benefit (leaving aside a fun strategy using 99-year GRATs). With traditional 2 year GRATs the mortality risk was not perceived as that significant. If you opt for longer term GRATs you could eat your Wheaties but you’d be better off calling your life insurance agent and investigating the feasibility of insurance to track the GRATs. **Example:** You use a 10 year GRAT so dividends on the family business interests will cover the annuity payment and avoid leakage of equity back to your estate which may not qualify for discounts in future planning. Perhaps you should have your life insurance trust (or if

you prefer to talk in acronyms, your ILIT) buy a 10 year term policy. If you die within 10 years the assets of the GRAT are generally included in your estate, but if that happens the 10 year term policy will pay off. If you outlive the term of the GRAT your GRAT plan should succeed and you won’t need the term policy.

■ **Illustration.** Here’s an illustration of how you might tackle pre-2704 Reg discount planning to lock in discounts and deal with some of the potholes to successful planning. Husband transfers 50% of the family business interests to

Wife now. Husband forms a trust in Alaska naming an Alaska trust company as trustee. The trust is structured as a directed trust naming Husband as investment advisor so that he retains management control over the family business interests that will be gifted to the trust. This approach also permits limiting the fee an institutional trustee will charge to a more modest flat fee per year for administration since the trust company avoids liability for managing the assets. The business interests are appraised. Husband

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CHECKLIST: PROTECTORS

Summary: Trust protectors have become more commonly used in irrevocable trusts. There are good reasons to make the role ubiquitous in revocable trusts as well. The law tends to view revocable trusts as will substitutes and therefore does not give remainder beneficiaries the right to demand an accounting if a trustee is being bad. A trust protector, acting in a fiduciary capacity, might resolve that. But with all the talk of trust protectors, what might these folks do? While there can be significant variability in the duties or rights given a protector, consider some of the following:

- ✓ Modify the trust as necessary to qualify the trust as a grantor trust to achieve the income tax objectives of the trust.
- ✓ Modify the trust as necessary to qualify the trust as a special needs trust or to otherwise assure that a particular beneficiary can qualify for governmental benefits. This is rather important as the rules vary from state to state and may change over time. A trust crafted to qualify for governmental benefits in one state may not achieve this fundamental goal if a beneficiary moves to another state and

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transfers 40% of his interests to his Alaska SLAT (spousal lifetime access trust that benefits the wife, children, etc.) based on an appraisal report. The gift is made using a Wandry defined value mechanism. This means that the gift is of a specified dollar amount of interests in the family business, e.g. \$3.36M, not the 40% intended transferred. In this way, if the IRS attacks the appraisal as too low the taxpayers position is that they did not gift 40%, but rather \$3.36M. Absent the IRS successfully challenging the valuation, the appraisal of the 40% interests at \$3.36 million [$\$14 \text{ million} \times 40\% \times (1-40\% \text{ valuation discounts})$] means the intended 40% interest would be transferred. Wife formed her SLAT in South Dakota naming a trust company there to serve as trustee. Again, Husband who has managed the property for 40 years is named as the investment adviser under the directed trust.

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Wife contributes \$1 million in marketable securities to her SLAT in 2016. All documentation is completed for the Wife to transfer 35% of her interests to the South Dakota SLAT but the transfer is not consummated yet. Instead, the Wife waits until the final Regulations are to become effective and transfers her LLC interests in 2017 prior to that date. The risks of a challenge based on the reciprocal trust doctrine have been minimized by more differences in the trust documents, using different institutional trustees, different states for situs and governing law and different assets. If the IRS finds that the trust Husband and Wife created for each other are too similar they could “uncross” them putting each back into the respective estates. This is a tax doctrine by which the IRS could disregard some steps in a plan as not having economic affect and thereby recast the transaction in an unfavorable manner. The risks of the step-transaction doctrine undermining the plan have been reduced by having time pass between the transfers and having the transfers occur in separate tax years. Further the declaration of a dividend while Wife held the stock arguably demonstrates economic substance to the Wife’s holding of business interests before the gift to her trust. Because the trusts have been established in trust friendly jurisdictions, when the parents die and grantor trust status is turned off, the descendants who will then be the beneficiaries can avoid state income taxation by letting income that is not needed accumulate inside the trust.

■ **Hillary vs. Donald Plans:** Hillary has proposed reducing the estate tax exemption to \$3.5 million, the gift exemption to \$1 million and increasing the tax rate to 45%. Hillary might limit the cool estate tax planning tools President Obama has proposed restricting for years (GRATs, IDITs and lots of other acronyms). Wealthy taxpayers could lose many

planning options (not just discounts) if they don’t act. But might Donald repeal the estate tax? Sans my Ouija Board no one can be sure. While many estate planners think Congress will be too gridlocked to pass the Grey Poupon, banking on that could be at your peril. The anti-1%, anti-

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wealthy mood has never seemed worse and a shut-down of techniques used by the wealthy to plan (unwarranted loopholes in the view of others) might be in the offing. So, what do you do? You plan now, but plan flexibly and creatively, which is not what many who regretted 2012 planning did. So what does a taxpayer do?

■ **Hillary Wins:** Hillary might reduce the estate exemption to \$3.5M and the amount you can gift to only \$1M. If you’re planning to lock in discounts because of the Reg change why not use exemption in case Hillary wins? If you’re already planning why not play the full game?

■ **Donald Wins:** If Trump wins he won’t try to make the estate tax great again, he’ll try to eliminate it. To plan for this possibility be sure whatever planning you do to address the new proposed regulations eliminating valuation discounts and the risks of a Hillary win is done as flexibly as possible. You want Gumby like trust documents! Don’t transfer wealth to trusts for only children and later descendants. Design trusts to include a spouse/partner (e.g. spousal lifetime access trusts or SLATs), or even include yourself (e.g., a domestic asset protection trust or DAPT). PP

...CHECKLIST: TRUST PROTECTOR POWERS

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either that beneficiary or a descendant needs to qualify for governmental benefits in that state.

✓ Appoint a new general trustee, investment trustee, and perhaps even have the power to replace or appoint new persons to serve in other non-fiduciary positions. This might include a person designated to loan funds to the grantor without adequate security, or a person empowered to designate or add a charitable beneficiary (these being included to characterize the trust as a grantor trust).

✓ The power to demand an audit of the trust to provide a check and balance on the trustee. The trust might specify that perhaps once per year or every two or three years such an audit could be completed at the expense of the trust itself. The protector may also be given the discretion to submit an accounting to court. It might warrant having a limit on how often this can be done to balance the protection afforded without permitting the power to become abusive.

✓ The right to change the situs of the trust to any jurisdiction. This can be important to minimize state income tax. Also, if asset protection becomes more important, or if the state where the trust is based changes its law or the case law in that state develops in an unfavorable direction, moving the trust to a better state might be advantageous. The protector might expressly be permitted to rely on a written opinion of counsel for this type of action.

✓ The authority to appoint successor protectors.

✓ Correct scrivener's errors to avoid the need for court action.

✓ Modify administrative provisions that have no effect on the beneficial interests in the trust.

✓ Restrict or eliminate the right of the Trustee to apply the income of this trust to pay life insurance premiums on the life of the grantor. This might be useful to assure that the

grantor trust status of the trust can be turned off.

✓ Change the name of the trust.

✓ Giving notice of the existence of the trust and trust financial data to beneficiaries has grown as an issue in recent years. Many state laws require beneficiaries above a certain age to generally be informed of this information. However, in some instances, such as a beneficiary with a drug or spending problem, awareness of a significant trust could be problematic. How can a trust balance the requirements of law, the protective power of having those with a vested interest in the trust have knowledge of the trust, and the possible harm to some beneficiaries of this information? Perhaps the protector can be given the power to di-

rect the trustee as to which beneficiaries, should be excluded from the general notices given.

Other points to consider:

✓ The trust should expressly state whether the protector acts in a fiduciary capacity. Watch state law on this point.

✓ Should the protector be entitled to compensation (probably) and if so how should it be calculated?

✓ Should the protector be required to sign the trust instrument or a counterpart to begin serving?

✓ What steps should the protector take to fulfil his or her duties as protector? Review the trust. Meet other advisers annually (trustee, wealth manager, CPA, etc.). Obtain guidance from legal counsel as to what your duties should be.^{PP}

RECENT DEVELOPMENTS

■ **Divorce Property Transfers:** The transfer of a business interest between former spouses, after their divorce, qualified for nonrecognition treatment under Code section 1041. *Belot v. Commissioner*, T.C. Memo 2016-113. Divorce property settlements can be tricky. Be sure the agreement is clear as to the intended tax results of each agreed item.

■ **Death with Dignity, End of Life Decision Making:** 4 states (CA, OR, VT, and WA) have an End of Life Options act that may enable a terminally ill patient to obtain a lethal prescription to end his or her life. Some of the concepts these laws include are: ► The patients must make several requests for this treatment (oral, written and with a prescribed number of days in between to be certain that the intent has not changed). ► The physician must determine that the patient has a terminal condition and a life expectancy less than 6 months. ► The physician must determine that the patient has the cognitive ability to make the request. ► If the patient's judgment is impaired a psychological exam may be required. ► The physician must confirm that the decision wasn't the result of coercion or undue influence. ► The patient must be informed of alternatives including palliative care. ► A second physician must confirm the findings. ► The cause of death is should not be listed as suicide. So insurance, wills, and contracts should be treated as if the person died from the terminal illness.

■ **South Dakota Community Property Trust:** The estate planning world has become preoccupied with maximizing income tax basis on death to minimize future capital gains. If you own assets and die, the tax basis of your assets will be increased to their date of death value. Not so for assets owned in your surviving spouse's name. South Dakota now has a statute, effective July 1, 2016, which permits married couples, even those living outside the state, to create a community property trust to hold assets. This Harry Potter-like technique will have all trust assets treated as community property under SD law so all assets should get a full basis step up on death of the first spouse. SDCL Ch. 55-17. ^{PP}

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■ **Validate Wills/Trusts:** Family dysfunctional? Anticipating family lawsuits? In Alaska, Arkansas, Delaware, Nevada, New Hampshire, North Carolina, North Dakota, and Ohio you can bring a proceeding to have your will validated while you are alive, obviating a later challenge. In Alaska, Delaware, Nevada, and New Hampshire you can validate a trust.

■ **Foreign Account Reporting by Agent under Power of Attorney:** The government has been clamping down hard on reporting of foreign accounts. If you have a foreign account will the agent under your power of attorney be liable for not addressing all reporting requirements for your foreign accounts? What if your agent did not know of these accounts? One approach is to have your power of attorney document specifically exclude any power over any foreign account unless the agent has expressly accepted such power. If the agent

under a power of attorney could be held liable should guardianship/committee appointments be similarly crafted? What about revocable trusts? Many people use blanket/broad/generic assignments to transfer assets to a revocable trust. What does that mean to a successor trustee? For that matter, should all successor trustees then exclude authority over foreign accounts in their acceptance?

■ **Donating Your Body for Scientific Research:** Donating your body for medical research can be a noble act that can save lives. But advance planning is recommended. The Uniform Anatomical Gift Act provides guidelines for the bequest of your body. If you're an adult and of sound mind you can donate all or any part of your body for any scientific purposes specified. The donation is to any accredited medical, dental school, college, or university and it must be used for education, research, advancement of medi-

cal or dental science or therapy. Be certain to sign the appropriate documents now. Also, provide for arrangements in the event that the institution you donate your body to cannot accept your body (due to disease, or an excess of donors at that time). If you donate your body a funeral will not be possible as the institution will require that your body be transported immediately following death. Certainly any type of memorial service will be permissible. Following the use of your body your remains will be cremated so your documents should also address what happens to your ashes. PP

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