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Shenkman
PRACTICAL PLANNER®

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WAS YOUR ESTATE PLAN TRUMPED?

Summary: So the Viking wants to know what's in your wallet. But if you thought it was complicated figuring out how to get the most points out of a credit card rewards program, that ain't nuttin compared to finding estate planning Valhalla. This has been a wild year of estate tax changes, but next year may be the 100 year tax wave.

■ Recent Estate Planning Changes and Developments: 2016 was a busy year for estate tax planners. ■The IRS issued regulations requiring estates to list tax basis of assets passing to each beneficiary and From 8971 to report this. For some estates this created complexity and compliance costs. ■In August the IRS issued Proposed Regulations under Code Section 2704 that would decimated valuation discounts (e.g. 30% of a $10M limited partnership may be worth $2M but $3M if the Regs are finalized as is). These Regs were incredibly complex, like 3-demensional estate tax Sudoku, and pushed planners and clients to panic and rush to complete planning based on current discounts. Then the IRS backpedaled from what most perceived as the harsh tack of the Proposed Regs. Treasury officials suggested that all valuation discounts would not be eliminated and that the Regs were unlikely to be finalized until well into 2017, or later. ■ NJ repealed its estate tax in 2018. In 2016 the NJ exemption was the lowest in the country at $675,000 but that will increase to $2M in 2017. The tax is repealed in 2018. That affects more than Jets fans. Folks in NY that don't want to move to FLA to escape the NY estate tax can now hop over the Hudson in 2018 and save a bundle. Gee who would have thought that NJ was a tax haven? Now Manhattanites can save estate tax, see the grandkids, and skip the sunscreen. ■But not all big changes are tax related. Every year there are scores of important court cases and state laws that have a profound impact on estate planning. ■ For example, New Jersey passed its version of the Uniform Trust Code providing new flexibility, guidance and planning options to those creating trusts in NJ. ■ But all these changes pale by comparison to what happened November 8 when Trump and the Republicans took Washington with control of the White House, House of Representatives and the Senate. Trump's tax platform included the repeal of the death tax. The Republicans have long wanted to repeal the estate tax and 2017 might just be the year. Cowabunga dude! Does this make your estate plan a mutant?

■ Estate Tax Repeal: Trump may well succeed in repealing the estate tax. The tax has become so complex, so despised, raises less than 1% of federal revenues, and seems ineffective in preventing wealth concentration, that perhaps the estate tax will finally be repealed. The likelihood of repeal is unpredictable. Will the gift tax also be repealed? While many think it will not as it backstops the income tax system, Congress might just toss the whole transfer tax system including the gift tax. Trump proposed a Canadian-like capital gains tax on death.

■ Let's Wait and See: Some planning gurus are recommending folks sit tight and see whether the estate tax will really be Trumped or not. That makes no sense. Certainly the planning that is undertaken should reflect many of the possible changes, but planning in modified form should continue for many if not most people. Part of the "sit tight" issue is that advice was only likely meant for those wealthy people considering planning techniques that had a significant gift tax exposure. But the key point for everyone ("everyone" includes YOU) is to review your

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CHECKLIST: NOTRE DAME

Summary: The 42nd Annual Notre Dame Tax & Estate Planning Institute was recently held in South Bend. Lots of great speakers and great planning ideas. Below is a selection of tips gleaned from the conference. For almost 100 pages of notes on the program see www.shenkmanlaw.com blog.

√ Family Limited Partnership (FLP) Victory: FLPs have been a staple of estate planning so to understand when they work, a review of the recent Purdue case is helpful. Don't discard this knowledge even if the estate tax is Trumped as FLPs and LLCs will remain staples for asset protection and all the other reasons cited in this case. The IRS challenged the transfer of assets to the FLP as not meeting the adequate and full consideration requirement. They also challenged gifts of FLP interests as not meeting the preset interest requirement for gift tax purposes. The FLP held marketable securities in separate accounts managed by different firms. There was also an interest in a net leased rental property. The business purpose argued by the taxpayers was consolidation of assets and aggregation to meet qualified investor requirements. The Court held for the tax-

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planning and assess what the myriad of recent changes and possible future changes might mean. And this includes folks of more moderate wealth too. "Wait and see" without evaluating options is really a dangerous "uniformed waiting to see," not smart.

■ Review your Dispositive Scheme: ■What do your will/revocable trust provide? This is vital for everyone to consider. Many will distribution provisions are based on tax formulas. That's just the nature of the beast. Depending on the wording used (and slight nuances can make a big difference) the recent and possible future tax changes might undermine your entire plan, or make little practical difference. ■If your will provides that the maximum amount that can be bequeathed without triggering a federal or state estate tax passes to a credit shelter trust (often a family trust that includes the surviving spouse and descendants) what happens if state and federal estate tax are eliminated? Does the maximum amount that will not trigger tax mean your entire estate? Or perhaps, depending on the wording used, no assets pass to the credit shelter trust, and your entire estate may pass to a marital trust. Might you care? ■In some cases it may not matter. For example, if the credit shelter trust had your surviving spouse as the sole beneficiary, the practical difference of assets passing to the credit shelter or marital (QTIP) trust might not be significant. But if the credit shelter trust benefits only children from a prior marriage, and the QTIP/marital trust benefits your new trophy husband, the difference could be big. ■Bottom line — the smartest decision is to review how recent and possibly future changes might affect your plan. If the differences could be significant update your documents now. If the differences are likely to be tolerable, then you might take what will now can be called an "informed wait and see" approach.

■ Planning for Change: Lots of clever stuff might be done to address future changes. Perhaps use a Clayton QTIP approach in a new will. All assets pass to the QTIP but what an independent executor does not elect to qualify for the marital deduction passes instead to the credit shelter (family) trust. This gives the executor 15 months following death (if the estate tax return is extended) to shift assets to the preferable trust. If a new capital gains on death tax won't apply to a credit shelter trust perhaps the assets could be shifted to that trust. If a marital trust is the only way to defer that tax, perhaps all can be elected for marital. For new irrevocable gift trusts consider granting an independent person a power to vest assets back in the grantor under Code Section 2038 if that proves more advantageous. The person could give the grantor the right to control who may enjoy trust assets and thereby cause those assets to be included in the grantor's estate for basis step up purposes. For some, just stating that if all estate taxes are repealed the credit shelter or the marital trust must be funded might suffice. But planning is possible.

■ Cost/Benefit of Waiting: If the gift, estate and GST tax were repealed tomorrow what should you do? Consider shifting as much of your wealth as possible into irrevocable, but flexible, grantor trusts in trust friendly jurisdictions. Huh? If there is no tax why use this traditional tax planning? Because these trusts provide significant protection from lawsuits, claims, divorce, elder financial abuse and more. The gift and transfer taxes served as a major impediment to this type of planning. If all transfer taxes disappear jump into planning! But most commentators believe that the gift tax will not be repealed. If the gift tax will remain, as most suggest, what benefit is there to waiting? You will still face the same hurdles leveraging assets into protective trust structures. If assets should be in those structures regardless of the transfer taxes, why wait? If the gift tax is repealed and you acted sooner what is the downside? You might face gift tax exposure. But that can be moderated with defined value mechanism. If the gift tax is eliminated you could transfer assets without GRATs, sales, appraisals, etc. But that cost is likely modest relative to the assets involved. What if you are sued before planning is implemented? Waiting could prove costly. PP

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Reviewer: *Andrew Wolfe, CPA, Esq.*
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...Checklist: Notre Dame Estate Plan Tips

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payers noting that there was no commingling of personal and entity assets, assets were properly transferred to the entity, the entity formalities were adhered to, and the taxpayers were in good health when the entity was created. The case also involved a Graegin loan which was upheld even though there were assets outside the entity that might have been used to pay estate tax. With a Graegin loan a loan is made to the estate to be used to pay the estate tax, The loan cannot by its terms be prepaid so that the estate can deduct all of the interest to be paid over the life of the loan thereby saving estate taxes. Estate of Purdue v. Comr., TC Memo 2015-249.

√ <u>State Taxation of Trusts</u>: A trust was created by a Massachusetts settlor but could Mass. tax the trust? The corporate trustee was an "inhabitant" of Mass. because it had 200+ offices in Mass. and conducted trust administration activities there, these factors made it a Mass "inhabitant" even though its corporate headquarters and principal place of business were in North Carolina. Bank of America v. Comr. of Revenue, 2016 WL 3658862 (Mass.).

√ <u>In Terrorem Clauses in Wills</u>: Estate litigation is exploding. You would think courts would welcome these clauses to minimize litigation, but they haven't. Courts have expressed concern over the possibility of a perpetrator inserting a no-contest clause in a will to hide an undue influence issue. The Uniform Probate Code (UPC) provides that a provision in a will purporting to penalize an interested person for contesting the will relating to the estate is unenforceable if probable cause exists for institution proceedings. A recent case held the in terrorem clause void as against public policy and noted that the courts exist to determine the truth. Parker v. Benois, 160 So. 3d 198 (Miss. 2015).

√ <u>Divorce and Inheritance</u>: If you sign a will and then you divorce UPC Sec. 2-804(b) treats it as if the divorced spouse disclaimed. But what if your will leaves property to a relative of your former spouse? What about your ex-brother-in-law? The relative of your ex may be permitted to take under your will as the removal of the former spouse may not apply to the family member of your ex. Haste v. Vanguard Group, Inc. 2016 WL. Some cases have held that the former spouse's relative only inherits if he or she survives the former spouse. Estate of Mower, 2016 WL 2647566 (Wash. Ct. App.) brother of former spouse inherited. Smarter move is to revise all your documents post-divorce and remove any relatives of your ex unless really you intend that they benefit.

√ <u>Revocable Trust and Incapacity</u>: Revocable trusts, properly done, can be an excellent tool to protect folks as they age. Settlors of a joint revocable trust were their own trustees. The remainder beneficiaries had no right to receive accountings while the trust settlors were acting as trustee. Babbitt v. Superior Court, 246 Cal. App. 4th 1135 (2016). Consider naming a trust protector who can monitor the status and seek an accounting and/or an institutional trustee as a safeguard. In another case the husband used a power of attorney to change title to assets into a revocable trust. This changed the ultimate distribution and was deemed a breach of his fiduciary duty under the POA. Liberty Bank v. Byrd, 482 S. W. 3d 746 (Ark. Ct. App. 2016). PP

Recent Developments

■ <u>Trust Modification</u>: ■Modification of an irrevocable trust did not cause adverse tax consequences. ■The PLR stated: "Due to unforeseen and unanticipated circumstances, payment by the Grantors of the income taxes on Trust's income has become unduly burdensome…Under Statute, the court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration, or if, because of circumstances not anticipated by the settlor, modification will further the settlor's stated purpose or, if there is no stated purpose, the settlor's probable intention." ■The PLR discussed Rev. Rul. 2004-64 concerning the tax reimbursement clause added, assuming there is no understanding, express or implied, between either Grantor and the Independent Trustee regarding the Independent Trustee's exercise of discretion, the Independent Trustee's discretion to satisfy either of the Grantor's obligation would not alone cause the inclusion of the trust in Grantor's estate. ■However, such discretion combined with other facts (e.g., an understanding or pre-existing arrangement between Grantor and Independent Trustee regarding exercise of this discretion; a power retained by Grantor to remove the trustee and name the grantor as successor; or applicable local law subjecting the trust assets to the claims of Grantor's creditors) may cause inclusion of Trust's assets in Grantor's gross estate. ■With respect to the swap power the PLR cited Rev. Rul. 2008-22 concerning avoiding estate inclusion. ■The swap power must be exercisable in a nonfiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value. ■The trustee must have a fiduciary obligation (under local law) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value. ■Also, the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries. PLR 201647001. PP

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■ **Broke Retirement: ■Here's some terrifying stats: ■62% have less than $1,000 in a savings account. A leaky hot water tank could put them out! ■28 percent said they have $0 saved. So much for rainy day funds! ■In most states, 30 percent or more of residents have no money in their savings accounts. ■ 60%+ of residents in 44 states have less than $1,000 saved. 2015 survey, GOBankingRates.com**

■ **QTIP Election: The IRS has granted an extension of time to make a QTIP election with respect to a marital trust. PLR 201641018.**

■ **Grantor Trusts: Grantor trusts can provide an array of incredible benefits and be applied in a myriad of ways. Not many people consider that a trust can be a grantor trust as to another. Consider IRC Section 678 - Person Other Than Grantor Treated as Substantial Owner. Trust 1 made a transfer of all assets to Trust 2. PLR says the deemed grantor of Trust 1 becomes the deemed grantor of Trust 2 even though Trust 1 created Trust 2. Poof, Trust 2 is a grantor trust as to Trust 1. PLR 201633021.**

■ **Social Security: Designate the person is who is named agent under your power of attorney as your Representative Payee in the event that you cannot handle your checks on your own.**

■ **Pulling Hair out over Heirs: v. 61% of high net worth parents are not confident that their children are well prepared to handle a financial inheritance. Start by having adult children attend meetings with your wealth manager and estate planner. Proactively begin educating them. Buy them a financial plan for their birthday!**

■ **Revise Wills/Revocable Trusts: The impact of possible state and federal estate tax changes could undermine your intended dispositive scheme. Consider amending your documents to confirm your intent. Example: "If both the federal and state estate tax have been repealed, it is Grantor's preference that the entirety of the trust estate pass to the Credit Shelter Trust and not to the QTIP marital trust unless, however, such transfer would trigger a capital gains tax on death. In the latter case, then the maximum amount may be transferred to the Credit Shelter Trust that will not trigger a capital gains tax on death if such a tax exists, and the remaining estate shall pass to the QTIP trust. Grantor gives the Independent Trustee latitude to interpret and apply these provisions in the event of tax law changes occurring after the execution of this Trust."**PP

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