AK-EPC
Estate Planning Opportunities under the Tax Cuts and Jobs Act

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A KEY ESTATE PLANNING GUIDE

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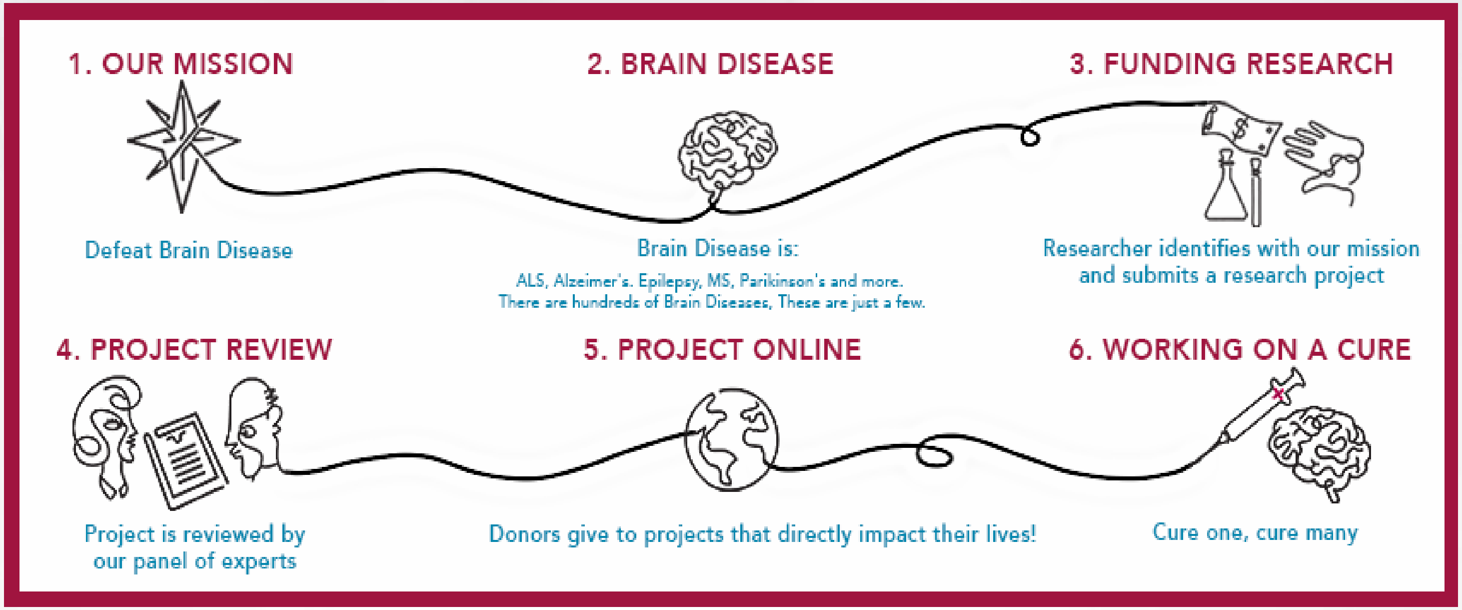

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5 Topics

- 1-Planning for increased temporary exemption.
- 2-Large estate planning during the current window of opportunity.
- 3-Trusts – new planning/drafting approaches.
- 4-199A – some additional thoughts.
- 5-Miscellaneous planning ideas post TCJA.

1 – Planning for Increased Exemption

1-Increased Temporary Exemption

- Incredible planning opportunity.
- Use it or lose it – must explain this to clients (2025 sunset; legislative change before).
- Wealth - Look at client's current and future wealth. Net Worth $5M might be $10M+ in 2026.
- Complex/inconsistent goals for "moderate" wealth clients: access, income tax issues, completed gift challenges.
- UHNW clients: business as usual, augment existing plans.

1-Common Plans to Use Doubled Exemptions

- SLATs: Non-reciprocal spousal lifetime access trusts ("SLATs") to use exemption but preserve access.
  - Avoiding reciprocal trust status.
  - Power to loan to permit access to assets.
- DAPTs: (variants - power to add settlor as beneficiary, or distributions to settlor in discretion of non-fiduciary).
- Basis: Consider 2038 power and other mechanisms to include in estate.

1-Asset Protection and Irrevocable Trust Planning

- Large use it or lose it exemptions will encourage gifting larger portions of wealth to secure temporary exemptions.
- Loosen old rules of thumb on percentage of wealth that can be transferred?
- Solvency affidavits and other due diligence - use more with greater portions of wealth transferred?
- Access to transferred assets if more of wealth transferred is critical. Reconsider: long term care and life insurance to protect transferors.

1-Planning: Simplify/Enhance Existing Transactions

- For more moderate wealth clients who have previously consummated note sale transactions, consideration should be given to immediately funding additional gifts to the purchasing trusts to shore up the economics of those sale transactions. On those transactions, consideration might be given to evaluating the need for the existing guarantees. On much larger transactions, the additional trust “capital” might be supportive, but have no meaningful impact on guarantees. On smaller note sale transactions, that additional $5 million gift might be used to pay off a portion or all of a note, thereby eliminating the IRS IRC Sec. 2036 string argument as to the note.

1-Planning: Using Low Wealth Family Member Exemptions

- Capture unneeded transfer tax exemptions of family members or others with modest wealth.
- The taxpayer could make a gift of highly appreciated assets to a close family member living in a non-decoupled state who has a modest estate of her own, who could bequeath those assets to the descendants of the taxpayer in a GST exempt long term trust. An obvious drawback of this is loss of control over the assets.
- Create an irrevocable trust with a general power of appointment (GPOA) to a person living in a non-decoupled state who has a modest estate of her own. The presence of that GPOA will cause estate inclusion of trust assets in that person's estate generating no estate tax but an adjustment of basis on her death. The exercise of the GPOA could be conditioned upon the consent of a non-adverse party providing a measure of protection. Alternatively, a limited power of appointment ("LPOA") could be provided to that person and another person can be given the power to convert the LPOA into a GPOA before the power holder's death. If the trust is formed in a jurisdiction that permits silent trusts, is there a need to even inform the power holder of the existence of the GPOA?

1-Planning: Using Low Wealth Family Member Exemptions

- An upstream GRAT could also be used. Acknowledgement to Turney Berry.
- **Example**: Clients have a net worth substantially in excess of the $22 million. The client's parents have a net worth combined of only $2 million. So, the clients create a GRAT that is calculated to vest in each parent somewhat less than the maximum amount which, when added to their other assets, would not exceed each parent's exemption at the time that each parent dies. The parents bequeath the remainder interest to a trust for the benefit of the client and the client's descendants. This transfer will not only use up the parent's estate tax exemption, but it can utilize each parent's GST exemption (because there is no ETIP with respect to the parent). The IRS should have no objection to this planning because it actually uses exemption, rather than being an assignment on day one (or two) of a nominally valued remainder interest.

1-Planning: Lower Wealth Clients

- For lower wealth clients, existing documents and planning will have to be reviewed. Many clients in this wealth strata will be inclined to unravel prior planning under the premise of “Why do I need this now?” Practitioners will have to educate these clients as to the value of retaining (whether modified or otherwise) existing planning from a number of perspectives. Many estate planning steps provide asset protection benefits and the transfer tax changes do not minimize the need for that. For some clients if the planning is already in place the modest cost of continuing to maintain that planning may be insignificant relative to the cost of unraveling the planning, and then having to reconstruct it in the future if the law changes yet again (e.g. a reduction in the exemption amount by a future administration).

2 – Planning for Large Estates

2-Large Estate Ideas – Sale to Non-Grantor Trust

- Sales to non-grantor trusts.
- Assets stepped up on spouse's death so no gain.
- Fractionalize sale between sale to grantor and non-grantor trusts.
- If pass on 1st spouse's death to QTIP need right to distribute. HEMS standard – will it work?
- Defined value clause must be two tier as there could be both income and gift tax audits.

2-Large Estate Ideas – Collateral Swap idea

- Sales to existing irrevocable trusts.
- Trust has grown substantially and has significant assets.
- Typical note sale transaction sell stock to irrevocable trust for note and secure with stock sold.
- Consider using different assets of the old trust as collateral for the note and not the asset sold.
- Does that reduce the link for challenge?

3A – New Trust Planning Constructs Post-JCJA

3-Asset Protection Planning-Are Non-Grantor Trusts Needed?

- Physician wants asset protection planning. Net worth $14 million. Under prior law would have had large estate tax. Creating and funding an irrevocable trust provided valuable tax as well as asset protection benefits. Under current law there is no tax benefit. Does that taint planning as solely for asset protection purposes?
- If use a non-grantor trust plan that provides immediate income tax benefit does that again provide a tax cover for the asset protection plan?

3-Trusts Structuring- SALTy SLATs

- Might these clients be able to structure completed gift (unlike the ING trusts), non-grantor (like the ING trusts) trusts to achieve multiple goals use temporary exemptions, access assets, and save SALT?
- Trust may distribute income to the client/settlor's spouse, or accumulate for future distribution to the settlor's spouse, all subject to the required consent of adverse party, and not be characterized as a grantor trust. IRC Sec. 672(a).
- An adverse party is a person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power. This might include trust beneficiaries, such as an adult child (Consideration must be given, of course, to whether an adverse party consenting to the gift would be making a gift.). 2514 default remainder beneficiary is an adverse party. ING strategy provides concepts.

3-SALTy SLATs Owning your Homes

- Use non-grantor trusts to multiply property tax deductions in high tax states to minimize SALT limitation impact.
- Transfer house and/or vacation home to an LLC. Election out of partnership status.
- Gift LLC interests to non-grantor trusts - SALTy SLATs.
- Each trust should qualify for a separate $10,000 property tax deduction.
- Be certain SALTy SLAT has enough income to offset property tax.
- Loss of Sec. 121 home sale exclusion. Convert back to grantor trust if SALT rules modified in future or if planning to sell house and want to start home sale 2 out of 5 ownership period.
- IRC Sec. 643(f): "…under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if— (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person…" SIIH Partners, 150 TC No. 3 (if no regulations issued the provision has no teeth).

3-SALTy SLATs – Drafting Tips

- Start with a form for a BDT.
- Trust should intentionally omit the swap power and other powers that might make it grantor as to the settlor.
- Delete the Crummey power included to make the trust grantor as to the beneficiary.
- Add requirement for approval or provide veto to non-adverse party on distributions to spouse.
- Form in trust friendly jurisdiction.

3-Trusts Structuring- Traditional INGs Post TCJA

- UHNW clients used incomplete non-grantor trusts to shift income out of the reach of state tax authorities. These trusts were funded with incomplete gift transfers and were structured to avoid grantor trust status. Large capital gain on the sale of stock earned inside ING avoids high SALT in a high tax state.
- NY Legislated against INGs – incomplete gift deemed grantor trust.
- Pending New York legislation, real estate tax could be deducted without limit and even if the taxpayer took a standard deduction on the federal return. Thus, using an ING in New York: non-grantor trust would be treated as a separate entity for federal purposes; and it would be treated as a grantor trust for New York purposes, which would result in the real estate tax deduction flowing through to the grantor's return for New York purposes (without limit).
- Post TCJA the ING is a great tool for ultra-wealthy clients that have used all of their exemptions and do not need to access assets in irrevocable trusts. For a large swath of clients it will not be the optimal trust structure.

3-Trusts Structuring- The Completed Gift "ING"

- Another variation in planning may occur because of the SALT changes and the doubled estate tax exemption.
- Clients with moderate (relative to the new high exemption amounts) wealth, who reside in high tax states, a different variation of all the above planning might be preferable if feasible to achieve. These clients, perhaps in a wealth strata of $5-$40 million may be sufficiently wealthy that estate tax planning should continue because the higher doubled exemptions may be rolled back in the future.
- These taxpayers are not be so wealthy that they can afford to give up access to those trusts.
- With the SALT deduction restrictions or elimination it may be prudent to shift investment income to a different no tax jurisdiction.
- Strip out powers given to grantor in ING trust that make it incomplete. Article forthcoming to describe which and why.

3-Trusts Structuring- BDITs

- Variation of the Beneficiary Defective Trust ("BDT") to address the SALT restrictions of the TCJA?
- In the traditional BDT (BDIT) the parent may create a BDT for a wealthy child with a $5,000 initial gift, so that the child could sell assets to the trust without triggering capital gain because the BDT would be grantor as to the child. A good plan, but how can this be spun for the Act?
- If the parent lives in a high tax state and the child in a no tax state, might a variation of the typical BDIT approach be used by the parent to shift income to a lower SALT environment to save SALT when they are no longer deductible?
- Mom gifts $5,000 to a BDIT that is grantor to son in a low tax state. Mom then directs business opportunity to the trust which has no discernable gift tax value. Bross Trucking. The income generated will be reported by son in the no tax state. The value of the business opportunity would be grown outside the parent and child's estate in contemplation of the sunset of the estate tax repeal.

3-Charity, Tithing and New Standard Deduction Regime

- Most taxpayers won't beat the standard deduction threshold thereby losing tax benefits of charitable giving.
- Form simple local non-grantor trust with a non-compensated family member trustee. Include 642(c) language.
- Donate enough investment assets to generate sufficient income to pay intended contributions.
- Name heirs as well as charities as beneficiaries and give trustee power to allocate.
- Can donate to charities and get full deduction, or direct to heirs in a given year.

3A – ESBTs

ESBT Summary of Changes

- The Act has made several changes that may affect ESBT's and provided several new instances of leniency which practitioners should be familiar with. These changes include:
- Lowered maximum individual tax rates to 37%. (Act section 11001.)
- Possible application of the "pass-thru" deduction for qualified business income (Act section 11011: new section 199A of the Code).
- Considerations of possibly forfeiting S corporation status to take advantage of the lower 21 percent corporate tax rates. (Act section 13001.)
- New bonus depreciation and larger section 179 expensing deductions which may flow through to the S shareholders, including an ESBT. (Act sections 13101, 13201.)
- Limitations on the deductibility of state and local income taxes ("SALT") by individuals and trusts which may prompt the review of the situs of some ESBTs and the possible move to a state with lower tax burdens. (Act section 11042.)

ESBT Taxation under the Act

- The portion of a trust owning stock of an S corporation with a valid ESBT election is treated as a separate trust while the other assets of the trust are treated as a separate, regular trust for income tax purposes, unless it's a grantor trust.
- The ESBT's share of S corporation income is generally taxed on its share of the S corporation's income at the highest rate of tax imposed on individual taxpayers. The Act has reduced that maximum rate to 37%, although section 1411 ACA 3.8% tax may apply since the NIIT has not been repealed.
- In addition, if the new pass-thru deduction rules apply there may be a further reduction in the rate.
- The ESBT's net income (whether distributed by the ESBT or not) is not taxed to the beneficiaries of the ESBT, although distributions from the ESBT portion may be gross income to the beneficiaries if the non-ESTB portion of the trust, if any, has other net income (DNI). See Treas. Reg sec. 1.641(c)-1(i).

ESBTs, S Corps. and Non-Resident Aliens

- Eligible beneficiaries of an ESBT include individuals, estates, and certain charitable organizations eligible to hold S corporation stock directly. A nonresident alien individual may not be a shareholder of an S corporation and may not be a potential current beneficiary of an ESBT. I.R.C. sections 1361(b)(1)(C) and (c)(2)(B)(v). The Act expands the list of permissible beneficiaries of an ESBT to allow a nonresident alien individual to be a potential current beneficiary of an ESBT. I.R.C. section 1361 as modified by Act section 13541.
- A nonresident alien still may not be a direct owner of S corporation stock.
- Planning Consideration: If steps had been taken to exclude a non-resident alien from inadvertently becoming a beneficiary of an ESBT that may now be reversed permitting such participation.

ESBT Charitable Contributions Now Subject to Individual Rules

- S corporations report to its shareholders their pro rata shares of certain separately stated items of income, loss, deduction, and credit. For this purpose, charitable contributions (as defined in section 170(c)) of an S corporation are separately stated.
- The deductibility of a charitable contribution that passes through from an S corporation depends on the shareholder. Because an ESBT is a trust, the deduction for charitable contributions applicable to trusts, rather than the deduction applicable to individuals, has applied to ESBT's.
- Generally, a trust is allowed a charitable contribution deduction for amounts of gross income, without limitation, which pursuant to the terms of the governing instrument, are paid for a charitable purpose. See I.R.C. section 642(c). No carryover of excess contributions is allowed.
- The Act changes the charitable contribution deduction of an ESBT and provides that the rules generally applicable to trusts are not applicable, but rather the rules of section 170 applicable to individuals control the ESBT's charitable deduction. Thus, the percentage of contribution base limitations and carryforward provisions applicable to individuals apply to charitable contributions deemed made by the portion of an ESBT holding S corporation stock. In addition, the ESBT should be able to deduct the fair market value of property gifted in-kind to charity, subject to applicable percentage limitations. The substantiation rules of section 170 would seem to apply, although those rules do not apply to trusts. IRC Sec. 642(c) as modified by Sec. 13542 of the Act.

ESBTs and 199A

- New IRC Sec. 199A(a) provides: “Sec. 199a. Qualified Business Income. ‘‘(A) In General.—In the case of a taxpayer other than a corporation, there shall be allowed as a deduction for any taxable year an amount equal to…”
- New IRC Sec. 199A further provides: ‘‘(i) this section shall be applied at the partner or shareholder level,…”
- The Conference Report clearly stated: “The conference agreement provides that trusts and estates are eligible for the 20-percent deduction under the provision.” If the provision clearly was intended to apply to trusts is seems incongruous that an ESBT would be precluded from claiming the deduction. Further, the new statute itself states that it shall be applied at the shareholder level and the ESBT is the shareholder.

ESBTs and 199A

- IRC Sec. 641(b) provides: “Computation and payment. The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary.”
- IRC Sec. 641(c) provides: “(C)The only items of income, loss, deduction, or credit to be taken into account are the following….”
- IRC Sec. 641(c) flush language at the end of the provision provides: “No deduction or credit shall be allowed for any amount not described in this paragraph, and no item described in this paragraph shall be apportioned to any beneficiary.”
- Clearly Congress intended to permit trusts to avail themselves of the 199A deduction as evidenced by the Conference Report and statute. It appears that not amending IRC Sec. 641(c) to add the 199A deduction was an oversight.

4 – Planning for 199A

4-199A Is it an SSB? Dividing SSB and Non-SSB Income

- **Example:** A physician operates a practice.
- An FLP, separate from the practice entity, owns the buildings where the practice operates and leases the facilities to the practice entity.
- Another FLP, independent from the practice and the real estate entity, was created by various family trusts and hired a graphics designer and marketing firm. Those contractors created a practice name, logo, slogan, consumer facing website (i.e., one without client data), and related marketing materials that were licensed to the practice. The practice operates under the licensed name, uses the licensed logo and marketing materials on all letterhead, advertisements, signage, website and more.
- Equipment was purchased and held in a third FLP. The equipment FLP leased equipment to the practice.
- These ancillary entities would all seem to be non-SSB's independent of the medical practice. Further, so long as the prices are arm's length for the rents and license fees the earnings in those entities should qualify for the IRC Sec. 199A deduction.
- Consider gifting ownership interests to irrevocable trusts non-grantor trusts each of which has its own threshold amount.
- Will the references in the Conference Report to apply 469 concepts to 199A negate this type of planning?

4-199A and 704(e)

- Client wants to maximize 199A deduction but has high taxable income. So gifts business interests to heir in lower income tax bracket below the threshold amount.
- Does it work?
- For a partnership (LLC taxed as partnership, GP or FLP) will IRC Sec. 704(e) and the requirement that capital be a material income producing factor impede the effectiveness of the gift?

4-199A and Real Estate Developers or Fund Managers

- Client wants to maximize 199A deduction but all employees for real estate empire (or investment fund group) are housed in separate management company.
- Can the property LLCs (separate fund entities) contract with the management entity and pursuant to the terms of that contract characterize the management entity as an agent for each property entity (can the management entity opt to be a disregarded entity) and each property entity report a pro-rata (or other appropriate) share of payments for employees and treat those as W2 wages?

4-199A and Real Estate Developers – Another Approach

- Client has a real estate management company formed as an LLC and 20+ separate property holding LLCs. Pre-TCJA there was no particular issue to this structure.
- Post-TCJA not having payroll on each building may reduce the 199A deduction (although the 2.5% of tangible property acquisition cost may alone provide a substantial benefit).
- Consider having the client/owner gift the LLC interests in the management company to each property entity. Then have the management LLC opt out of partnership tax status. The result will be that all income and expenses will be reported by each property LLC directly and wages may be available as part of the 199A calculation.

4-199A and Large Law and CPA Firms

- Form a REIT with leasehold interests.
- Smaller firms might band together and do the same.
- Leasehold interests are intangibles and cannot qualify for 2.5% calculation (that only applies to tangible property).
- REITs automatically qualify for 20% deduction.

4-199A Restructuring

- As clients restructure business entities to capitalize on 199A consider impact on buy sell agreements, estate plans (what if certain interests/entities are owned by a trust and others are not), etc. The ripple affects to address could be significant.

5 – Miscellaneous Planning Ideas for TCJA

5-C Corporations and Accumulated Earnings Tax

- Might C corporations that are accumulating earnings in the 21% C corporation solution use permanent life insurance to justify the funds?
- Consider revising buy sell agreements funded with term insurance instead with high cash value insurance.

5-Kiddie Tax and the NIIT

- Is there a change to the implications of this to the Net Investment Income Tax ("NIIT")? "The provision simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child... Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates…"
- It would seem that the Conference report suggests the application of a trust tax construct such that the threshold amount for NIIT purposes would be the $12,500 figure at which trusts reach the highest tax bracket.
- However, the threshold amount in IRC Sec. 1411 does not appear to have changed so that a child would appear to still qualify for the $200,000 threshold amount.
- So trust distributions to a child beneficiary might still facilitate avoiding NIIT.

5-Tax Preparation Costs No Longer Deductible - 1

- The Act repealed the deduction for tax preparation expenses. Under the provision, an individual would not be allowed an itemized deduction for tax preparation expenses. The provision would be effective for tax years beginning after 2017. Under current law, these expenses are miscellaneous itemized deductions only deductible in excess of 2% of AGI, so many taxpayers may not have received significant benefit in any event.
- **Planning Consideration**: This will likely result in taxpayers revisiting allocation of tax preparation fees as between business endeavors and personal returns preparation. Practitioners should be alert to possible ethical considerations if they bill the incorrect taxpayer (e.g. the client's business instead of the client for personal non-business services).

5-Tax Preparation Costs No Longer Deductible - 2

- Practitioners might protect themselves by cautioning clients in retainer agreements or a footer on bills, concerning the improper payment or allocation of fees.
- **Sample Provision**: "How you allocate legal fees, to various persons, entities or trusts could affect whether the payment is tax deductible. It is important that you use checks drawn on the appropriate accounts for the appropriate entities or persons when paying legal fees. Paying personal expenses from a business entity could be argued by a claimant or tax authority as evidence of your disregarding the independence and legal integrity of the entity. If you personally, or another entity, pays for legal fees for the services rendered to that person, entity or trust inappropriately, the IRS might argue that the payment is equivalent to an impermissible additional gift and that the tax position of the trust should not be respected."

5-Matrimonial Provisions

- Non-deductibility of alimony on divorces after 2018 is a major issue, but there are other minor ones of importance.
- Personal exemptions for children were commonly negotiated now they are gone.
- 529 plans can be used for elementary and secondary school. Parties may have contemplated only college. Now what?

5-Existing Durable Powers of Attorney

- Revisit gift provisions. Are they useful or necessary considering the exemption doubling? For many clients, the gift provision might warrant elimination by revoking the old power of attorney ("POA") and executing a new one that expressly prohibits gifts.
- For wealthy clients, they might wish to permit transfers of the exemption amounts but only to specified trusts. This might be appropriate if the clients are wary of using the new exemption amounts but want to facilitate further planning in the event they become incapacitated.

5-Charitable Giving Generally

- Fund donor advised funds (“DAFs”).
- Bunch deductions.
- Using IRAs after 70.5.

5-What and how to inform clients, dormant clients and others?

- Differs by practice. Planner with 100 clients can and will respond differently then a planner with 5,000 existing clients.
- Does email work? Older clients often don't have. Will that suffice?
- Consider a post-card. Extract data from electronic rolodex and email to printing/mailing firm to send.

Book on TCJA

- PDF download available at www.estateplanning2018.com
- e-Book available on www.amazon.com

Additional information

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