Leimberg Information Services, Inc.

Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2673

Date:22-Oct-18

Subject: Martin Shenkman's Day 2 Notes from the 44th Annual Notre Dame Tax and Estate Planning Institute

The **44th Annual Notre Dame Tax and Estate Planning Institute** was held on October 11th 12th at the **Century Center** in South Bend, Indiana. Members should click this link to review the meeting agenda: 44th Annual Notre Dame Tax and Estate Planning Institute.

The Institute presented topics of interest to a broad range of estate planning professionals, whether their clients are high net worth individuals exposed to the estate tax or more moderate net worth individuals who are below the estate tax exemptions. Of particular interest was the fact that a number of **LISI** commentators served as faculty.

Congratulations go out to program director and **LISI** commentator **Jerry Hesch** for this amazing two-track conference.

As in the past, the Institute provided topics focused on income tax planning, planning with non-grantor trusts, addressing new Section 199A, the new Proposed Regulations for 199A and 643(f), elimination or deferral of state income taxes, and much more. With dual sessions, individuals attending the Institute could choose topics relevant to their clients.

An area of particular interest were the sessions devoted to evaluating different life insurance policies and proposals using life insurance that sometimes seem too good. Another topic covered that will become increasingly important planning for the modern family. With seemingly constant tax law changes a number of sessions addressed integrating flexibility into trust and estate planning.

Over the course of many years, **LISI** has been delighted to provide members with **Marty Shenkman**'s notes from the proceedings at the **Heckerling Institute on Estate Planning**. Marty was a speaker at the **Notre Dame Tax and Estate Planning Institute** and has graciously

agreed to share his meeting notes from the sessions with **LISI** members.

Martin M. Shenkman, **CPA**, **MBA**, **PFS**, **AEP**, **JD** is an attorney in private practice in Fort Lee, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and more than 1,200 articles.

Marty is the Recipient of the 1994 Probate and Property Excellence in Writing Award, the Alfred C. Clapp Award presented by the 2007 New Jersey Bar Association and the Institute for Continuing Legal Education; Worth Magazine's Top 100 Attorneys (2008); CPA Magazine Top 50 IRS Tax Practitioners, CPA Magazine, (April/May 2008). His article "Estate Planning for Clients with Parkinson's," received "Editors' Choice Award." In 2008 from Practical Estate Planning Magazine his "Integrating Religious Considerations into Estate and Real Estate Planning," was awarded the 2008 "The Best Articles Published by the ABA," award; he was named to New Jersey Super Lawyers (2010-15); his book "Estate Planning for People with a Chronic Condition or Disability," was nominated for the 2009 Foreword Magazine Book of the Year Award; he was the 2012 recipient of the AICPA Sidney Kess Award for Excellence in Continuing Education; he was a 2012 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Counsels and in 2018 he joined the NAEPC National Board; and he was named Financial Planning Magazine 2012 Pro- Bono Financial Planner of the Year for his efforts on behalf of those living with chronic illness and disability. In June of 2015 he delivered the Hess Memorial Lecture for the New York City Bar Association. His firm's website is www.shenkmanlaw.com where he posts a regular blog and where you can subscribe to his free quarterly newsletter Practical Planner. He posts less technical consumer videos to www.laweasy.com and writes a blog for Forbes.com on charitable planning.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Martin Shenkman

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1. **Section 199A Minefield** - Alan Gassman.
    a. Net leased real estate
        i. Does not seem to qualify.
        ii. Sec. 162 is harsh test on rental real estate to be a trade or business.
        iii. Prop. Regs. Suggest that leasing land is "managed."
    b. Who takes deduction?
        i. K-1s will be more complicated.
        ii. Need to know ratable share of entity wages and how much qualified property it has.
    c. SSTB.
        i. Health.
            1. Includes doctor and massage therapist your doctor sent you to, but not clear if it would include a massage therapist you just went to.
            2. Blood lab not included rather does not see a patient.
            3. Pharmaceutical company is not an SSTB.
        ii. Law.
            1. Set up separate title company.
        iii. Accounting.
            1. Billing and personnel management might be able to be separated into a separate company.
        iv. Actuarial.
            1. Firms may divide.
            2. Insurance agencies are not included but complicated as many insurance agents sell financial products/services so may have to separate.
        v. Consulting.
            1. Unless consulting is part of selling a product and the sale is the vast majority of revenue, is an SSTB.
        vi. Athletes.
            1. Covered as SSTB.

d. Wage limitation rule.
    i. Single individual, complex trust or estate under $157,500 full deduction is available regardless of any other tests as to wages or qualified property.
    ii. If taxable income over $157,500 ($315,000) phase out over next $100,000 of taxable income and at $207,500. If SSTB no deduction at all over phase out range. For non-SSTB have allocation.
    iii. Example: Taxable income very low because gains on one business offset by losses of another the 199A deduction may be lost or very low.
    iv. Employee must do some work for company that is the common paymaster. If same client owns 3 entities and one company makes all wage payments. If an employee does not work for that company it may not work. Trap for unwary.
    v. Pension plan contributions and health care plan contributions are considered wages. So many clients may have enough wages based on inclusion of these items.
    vi. What do wages mean?
        1. Literal reading of statute excludes common paymaster and leased employees.
        2. If high income taxpayer wages must be double your deduction. Example: Factory has $100,000 of income you want $20,000 199A deduction you need wags of $40,000 to get that based on mechanics of the formula.
        3. Could you give yourself a $40,000 bonus to reduce income to desired level $40,000/$140,000? Wages need to be 28.7% of net income.
        4. Wages paid to owner of S corporation will satisfy statute.
        5. However, when a partnership pays a partner that is called a guaranteed payment and that is not a wage even though it looks like a wage. Statute made clear that you cannot count “wages” to a partnership. Planning idea: put partnership into an S corporation or gift partnership interests to spouse and let you the transferor spouse get the wage which won’t then be tainted as a guaranteed payment.
e. Tangible property test.
    i. You can multiply 2.5% of un-adjusted basis of tangible property owned by business entity and add to that 25% of wages and that can support 199A deduction. Example: $10M building x 2.5% is $250,000.
    ii. Most land is not depreciable.
    iii. Most real estate is. Use original cost basis.
    iv. If added improvements that is considered as a separate investment or property for 199A purposes and must track that separately for 199A purposes.
    v. If property completely depreciated and more than 10 years old cannot count it.
    vi. If took component depreciation wrote off large amounts in early years, say 5-year write off, get to include for at least 10 years.
    vii. Treasury regulations are legislative in this area.

viii. If complete 1031 exchange the older property is the acquisition basis and timing goes back. So, clients cannot expect 1031 exchange to improve the 2.5% tangible property test under 199A.

f. REIT and publicly traded partnerships ("PTPs").
   i. Automatically qualify for 199A.
   ii. Large real estate partnerships might convert to REITs for this reason. OK if triple net leased by REIT.
   iii. If own interest in REIT mutual fund do not get deduction. Must buy individual REITs and not REIT mutual funds. Large REIT mutual funds might have to restructure.

g. 754.
   i. On death of partner get new basis under 754 this will not provide new basis for
   ii. Could turn into tenants in common and liquidate the partnership so that basis adjust will adjust inside basis. **Comment**: Complexity, cost, possible loss of asset protection if in an LP.
   iii. Also, call in all partnership clients to address Powell case so open up discussion for all these points.

h. Reduce income to get client below taxable income threshold.
   i. Large 179 deduction.
   ii. Pension contribution.
   iii. Client with large capital gain put asset in CRUT and get deduction and avoid gain (defer).
   iv. Oil and gas deductions.
   v. Conservation easements.
   vi. Add families to payroll.
   vii. Bunch deductions.
   viii. Bunch compensation.

i. "Crack and Pack" strategies.
   i. Set up separate company to manage law firm. It can be an S corporation and handle management and marketing.
   ii. 15% of the bottom line owners and partners of CPA and law firms receive could be management income company fee.
   iii. Example: Medical practice nets $2M year perhaps $300,000 could be paid to a management firm. Put non-medical practice employees under that entity. The way the statute is written the physician could own both and the management company income would not be SSTB. But proposed regs added common ownership 50% common ownership and first entity does more than 50% of work for other entity it will all be considered SSTB income. Does IRS have authority to issue such a regulation? Not clear. But other persons, example, family members, could own management company. So, 4 children might own management company and they could get $157,500 each of income and qualify for 199A deduction on the management company income.
   iv. Practice management companies may pay a multiple of EBITDA and take management fee to recover payment. Doctor receives capital gain. Why

not set up management company owned by SLAT and have that purchase the practice on similar terms to an independent practice management company?

v. Since few/no clients will give ownership to child set up an irrevocable complex (separately taxed) non-grantor trust to own the interest. First $12,500 is at lower brackets and avoids Medicare tax. That saves $2,000. Then trust will receive 199A deduction.

vi. Proposed Regs say these multiple trusts may be disregarded/aggregated and lose the 199A deduction. Section 678 trust will be owned by beneficiary who is considered owned by beneficiary. So, can start with a complex trust and convert it into a grantor trust to child if the Reg is upheld/finalized in the same manner. So, set up as complex trust. If regs finalized trustee or other person can be given right to give daughter/beneficiary, the right to pull out all income including capital gains and that will make the trust grantor as to the child.

vii. Prop. Regs. Attacked crack and pack. If separate company owns less than 50% = non-SSTB. But if have 50% or more common ownership using also attribution rules then the separate company, e.g. management company suggested above, it's an SSTB if 80% of more of income comes from servicing the professional practice. Close friends can form billing company, own 49% each and let manager own 2%. But will attribution rules change in final regs?

j. ESBT.

i. ESBT should be entitled to 157,500 deduction and Prop. Regs. Do permit that. ESBT is deemed two trusts one for S corporation income and one for all other income.

ii. ESBT was not recognized in Code for 199A deduction but proposed Regs fixed that, but query whether the Reg has authority to do this.

2. **<u>Using Defined Benefit Plans to Qualify for Section 199A</u>** - Gerald Wolf

a. Here's Jerry's premise, very interesting "…*opportunity to utilize the cash balance plan as a vehicle to enable the owner of an SSTB to greatly enhance his or her opportunity for income tax deductions through the implementation of a qualified cash balance plan and, in the process, qualify not only for the 100% deductible contributions to such a plan but in addition, having those contributions effectively reduce the owner's taxable income to less than the "threshold amount" under Code Section 199A and thereby qualify his qualified business income for the 20% pass through deduction*."

b. Pension planning in the new environment.

i. Properly planned a client may be able to increase deductible pension contributions that primarily benefit themselves.

ii. Additional contributions will provide a deduction that will reduce taxable income to less than $315,000, the 199A threshold amount.

iii. Limiting taxable income may enhance the opportunity to take a 20% pass through deduction under 199A.

iv. Client could have significant funds added to his tax qualified accounts.

v. This could reduce income subject to state tax lower taxes that would not be deductible because of the new SALT limitations.

c. Retirement plan avoids issues with other planning.
   i. Proposed Regs under 199A may limit use of non-grantor trusts as an option to avoid the taxable income threshold.
   ii. Licensed professionals may not be able to transfer equity in their practices so even if non-grantor trusts work from a tax perspective certain planning may not be legally viable.

d. Cash balance ("CB") plans.
   i. Tax deductions are permitted within the limits under Code Sections 404 and 415 for contributions to CB Plan.
   ii. Contributions to the CB Plan can vary from year to year as long as the benefit accrual rules are satisfied.
   iii. CB plan usually bases contributions on participant's compensation for the plan year, not on his final average compensation amounts.
   iv. Contributions to a CB Plan increase with the age of the owner.
   v. "*A CB Plan is referred to as a hybrid pension plan because its benefit formula and payment method makes it looks very much like a defined contribution plan. Each year the employer makes a contribution to the participant's "hypothetical account balance" which is really a notional bookkeeping account used to determine the participant's benefit entitlement. The contribution credited to the account is usually based upon a percentage of the participant's compensation but can be a flat dollar amount or a variable amount based upon age and/or years of service*."
   vi. "The vesting schedule under a CB Plan must be 3-year cliff vesting, i.e. no vesting for three years and 100% vesting after three years of service."

3. **<u>Passing the Family Business on to the Next Generation When Some of the Children Will Not Be Active and Treating All the Children Equally</u>** - Austin Bramwell.
   a. Succession planning?
      i. How do you treat children "equally" if most of estate is family business and some children are involved and some are not involved in the business?
      ii. "There is no solution that will accomplish everything."
   b. Passing on the family business – common challenges.
      i. Business partners – need a deal if one of them wants to leave.
      ii. Who will be ultimate decision makers when matriarch is no longer holding business together.
      iii. Some children may be interested and be capable of managing and others who are not interested in the business but are also deemed equal family members.
      iv. Say father is owner and manager of business. Can you just divide up among children? Immediate issues arise. Sons' as not involved just want profits distributed. Daughter who runs business wants earnings reinvested. This could become acrimonious.

v. Pervasive issue in family business is that there are often/always "moochers" who do nothing to generate additional wealth and in the fact pattern, are the sons who are living off daughter's efforts.
vi. Daughter needs salary to live and for her efforts and sons may view it as excessive. Daughter will be viewed as looting the business and in many businesses that in fact is the case.
vii. Often there is not sufficient other assets to equalize.

c. Possible planning option - Financing.
   i. Give business to children equally and daughter in the business will borrow money and buy out other kids. Often this is unrealistic. But if done sons are out of business and do as they wish with their money. But daughter in the business has massive debt issue and there is financial fragility. If there is a downturn it could jeopardize the entire business.
   ii. Father might not like above outcome.
   iii. If business booms daughter could do great and sons buyout may with hindsight look unfairly low.

d. Possible planning option – Buyout using earnings.
   i. Give business to all and use earnings to buy out sons so less fragility for business and all family members share in risks.
   ii. Daughter is still prevented from reinvesting earnings since needs to service debt to sons.

e. Possible life insurance solution.
   i. This could be helpful. But must consider steps. What types of insurance should be purchased? How much will be purchased? Who will own it?
   ii. If buy enough insurance to buy out sons and equalize the inheritances. How much would you need? In example it might require $32M of insurance and the cost in this example would be too expensive.
   iii. What if daughter purchased $8M on dad's life and used that and other assets to buy out sons? That might be a viable option.
   iv. Tax advantages to insurance.

f. Preferred partnership interest.
   i. Earnings of interest must first be allocated to sons and their capital account since they own preferred before going to common.
   ii. Make priority cumulative so if cannot meet priority return requirement then will be made up (the arrearages) in future years.
   iii. If excess earnings that is when common gets its allocation.
   iv. Active members of business will get a salary = guaranteed payment which comes before the earnings/preferred interest. Managers will get this regardless of earnings and before allocations of net returns.
   v. Common interest holders can reinvest their share of earnings.
   vi. Father divides business between children. Sons get 6.67% priority return and an equal share of common interests goes to daughter.
   vii. Father dies. Daughter is CEO of the business and keeps making $800,000 earnings from the business. In first years 6.67% of capital sons get will get $200,000/son for their $3M capital "investment." That is a good return. $200,000 of excess earnings goes to daughter. She has to pay tax on that,

so a distribution is made and the remainder from that distribution is added to her capital account and can be reinvested in the business.

viii. Assume next year business earns less, say $600,000 sons get same amount of distribution as they have priority over common.

ix. Following year, year 4 business earns less than priority return and they the sons get less as a priority return and less than what their priority return rights provide for. But the shortfall generates a new asset = the right to receive a makeup of the shortfall in a future year when new earnings are realized and before payments to the daughter as common interest holder.

x. Year 5 there is a rebound. Son's get priority distribution and repayment of arrearages.

xi. Business booms and daughter then benefits on those future years.

xii. Ultimately business is sold. Daughter will benefit. If do asset sale proceeds are allocated in accordance with terms of partnership agreement. Daughter would get payments attributable to her increased capital account. Daughter as insider might be able to manipulate a result better for her. So perhaps work that out in advance so that some of windfall of sale is shared with sons. So, if there is a sale may have to satisfy capital accounts first and then provide for an allocation between active and non-involved heirs.

g. What if business organized as S corporation.

i. Cannot have different classes of stock only disparate voting rights.

ii. S corporation can hold as an asset a partnership and this permits replicating the structure described above.

iii. Daughter could be active partner.

iv. S corporation could hold the preferred interest.

v. Daughter and S corporation contribute to partnership and daughter gets back common interest and S corporation holds preferred interest. Father can bequeath S corporation shares to children and a similar result will be realized.

h. When to implement?

i. Assumed plan springs into being at father's death.

ii. Father may/should have done estate planning and may have already passed interests into trusts for children, GRATs or note sales may have been already completed, so in reality portions of plan will have been set before death.

iii. If there is an estate tax problem, there should be additional planning to avoid tax when exclusion amount reverts after 2025.

iv. Family business generate discounts by giving away interests Rev. Rule 93-12 permits gifts of fractional interests in same business with discounts.

v. IRC Sec. 2701 should consider when using preferred and common interests. Senior family member and if they hold priority interests or distribution rates or extraordinary payment rights and the junior family members (which includes spouse in both roles) you can artificial taxable gift and artificial increased valuation of the gift. 2701 is only a gift tax provision so if only make transfers at death you avoid 2701. You could to the opposite and father could give away entire business to next generation

and then it doesn't matter how interests in the business as long as father and an applicable family member retain no interest. Might consider a reverse freeze with father retaining common and giving away the preferred. There are 2701 exceptions. Guaranteed payments of a fixed amount are not treated as Sec. 2701 distribution rights. A "qualified payment" is not a problem so father could retain a preferred interest as described in the above hypothetical.

i. Private annuity sale even for health clients.
    i. Exception if client is terminally ill = incurable disease and 50% likelihood of death in one year if not can do a private annuity transaction and use tables. This will shift more of transferred property to shift free of gift tax.
    ii. The above is the traditional view of private annuity but that should not be the only instance in which a private annuity is used. Why? An elderly client may want to assure that she has adequate cash flow to live on for life. Perhaps tired of paying income tax on grantor trusts? Use a private annuity.
    iii. Private annuity terminates on death so there is no gross item of property to include on the gross estate because the annuity expires at death.

j. Charitable Remainder Trust.
    i. Be careful transferring business into a CRT.
    ii. Advantages of CRT – income tax deduction for remainder which must be at least 10% of value of what is transferred. CRT is a tax-exempt trust so if transfer low basis asset you shift gain from sale to tax exempt entity, so donor does not have to pay tax on it. The proceeds, not reduced by the tax burden, can be reinvested for the life of the client and spouse. That income/payment stream will carry the gain back out to the client but typically over lifetime.
    iii. Partnership conducting an active business – watch issues. Assignment of income doctrine which causes income to be attributable to the taxpayer who earned it. If transfer to CRT between contract and closing. Ferguson case. Also, a confiscatory tax on unrelated business income. 100% tax. But if have a partnership interest may pay tax for short period but if sale occurs as expected and gets around assignment of income risk it may be a good plan.
    iv. If client may live long enough, say 25 years, will have more wealth then if sold the business and pocketed after tax proceeds, even with no charitable intent.

4. **<u>Drafting for Flexibility in Trusts and Wills for Uncertain Times</u>** - Jerald Horn
    a. Modifying dispositive schemes post-2017 Tax Act.
        i. Pre-2018 plans that include tax-oriented formulae which determine the sizes of dispositions might produce unintended results.
        ii. Increase in exemption alters results of formula that determines credit shelter trust ("CST") sheltered from estate tax upon the death of the surviving spouse, compared to marital trust.
        iii. Increase GST exemption impacts exempt bequest.

iv. Formulae will continue to minimize estate and generation-skipping tax as originally intended.
v. If retain formulae consider modifying/favoring distributions to the surviving spouse, as by using a QTIP. Some clients may "rebalance" dispositions.
vi. State estate tax still complicates planning. Example: Illinois estate tax exclusion remains at $4M. State exemptions generally not portable. So, use some or all of the exclusion of each spouse, regardless of who dies first. Minimization state estate tax requires use of trusts/CST, even if no federal issue.
vii. Exemption increase could shift more to CST. Consider restoring prior benefit to surviving spouse by changing CST to the format of a QTIP.
viii. If the state of domicile decoupled and permits a state-only QTIP election, the increase in United States estate tax exemption may reduce marital/QTIP and) increase state-only QTIP.

b. Annuity trusts and unitrusts are compatible with the principles of modern-portfolio theory.
c. Trustee discretion.
    i. Consider authorizing trustee to distribute what the trustee believes the grantor, if serving as trustee, would make, including distribution of the entire trust estate and termination of the trust.
        1. Permits trustee to include trust estate in gross estates of one or more beneficiaries.
        2. Address portion of trust that is GST exempt.
        3. Transfer tax status of the permissible distributes
        4. Increase basis for income tax Sec 1014.
        5. Broad discretion permits trustee to avoid multiple incidence of GST
d. Tax risks of trustee discretion.
    i. Trustee deemed to own property she can pay herself, even if he or she does not exercise the power. Sec. 678(a)(1), 2041(a)(2), 2514(b).
    ii. Power holder can exercise to pay property to third party (non-general POA) can cause holder to make taxable gift because of enjoyment that the power holder forgoes. Rev. Rul. 79-327, 1979-2 C.B. 342, Estate of Regester v. Comm'r, 83 T.C. 1 (1984). **Commen**t: This is an issue to consider in the non-grantor trust status achieved by making distribution to a spouse contingent upon the approval of an adverse party. See Day 1 notes.)
    iii. Consider limiting distributions to ascertainable standard. Sec. 2041(b)(1)(A) and 2514(c)(1).
    iv. If power is a fiduciary power of a trustee limited by an ascertainable standard Reg. Sec. 25.2511- 1(g)(2) the exercise power is not a taxable gift.
    v. If trustee has a beneficial interest in trust property transfer not a taxable transfer if made pursuant to a fiduciary power the exercise or non-exercise of which is limited by a reasonably fixed or ascertainable standard which

is set forth in the trust agreement. Reg Sec 20.2041-1(c)(2); 25.2511-1(g)(2).

vi. Issue - whether person who has legal obligation to support distributee can exercise the power to discharge the personal obligation of the power holder. Approach - trust permits trustee to pay trust property to any one or more among a particular child and descendants for their health, education, and support (HEMS). Child can serve as trustee. Additional precaution: if the HEMS standard includes a requirement that the trustee consider resources available to distributee, and other resources exist that might deprive the power holder of all ability to use trust property to provide support for the minor child and hence avoid the issue.

vii. "In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised. Treas. Reg. §20.2041-1(c)(2), Treas. Reg. §25.2514-1(c)(2)."

viii. Speaker recommends drafting the standard explicitly to limit both the right to exercise the power and the right not to exercise it. Thus, the right not to exercise the power is discretionary only to a limited extent, and a beneficiary who the power can benefit can force its exercise. But, using an ascertainable standard might subject property to claims of creditors or controversy about rights of creditors.

e. 5/5 power.

i. Income tax implications of $5,000/5% power is right to withdraw causes powerholder to own all ordinary income subject to the power, and all income, ordinary and other, attributable to principal subject to power. Sec. 678(a)(1); Treas. Reg. §1.671-3.

ii. "*The IRS asserts that even after a right to withdraw lapses because the power holder fails to exercise it, if the power holder thereafter has such power or interest as would cause a grantor to be the "grantor" according to the principles of Code Sections 671-77, the power holder owns, for income tax purposes, all of the trust estate that was subject to the power. Code §678(a)(2); Priv. Ltr. Ruls. 200022035, 9034004, 8701007. This result depends upon (i) the theory that a "lapse" is a "release" for purposes of Code Section 678(a)(2) or (ii) the theory that a lapse of a right to withdraw has the same economic effect, and should have the same tax effect, as a withdrawal of property from a trust and a recontribution of the property to the trust.*

iii. Neither theory that is mentioned in the preceding paragraph clearly controls. The "five-and-five" rules of Code Sections 2041(b)(2) and 2514(e), on the one hand, state that a lapse is treated as a release except to any extent that a lapse within the limits of the five-and-five rules is not treated as a release. Code Section 678(a)(2), on the other hand, does not state that a lapse ever is treated as a release. Therefore, according to the argument, a lapse is not treated as a release for purposes of Code Section 678(a)(2)."

5. **Family Limited Partnerships: Section 2036(a)(2) and the Powell case** - David Handler and David Herzig.
    a. Powell.
        i. Estate of Nancy H. Powell v. Commissioner, 148 T.C. No. 18 (May 18, 2017).
        ii. *"…Section 2036(a)(2) by the IRS is so effective that it may pull assets back into the gross estate that were transferred using Family Limited Partnerships ("FLPs"), even if no discounts were used or claimed. In ….Powell… the IRS challenged an "aggressive deathbed tax planning" scheme. The decision reset some 20 years of prior precedent, creating a huge trap for the unwary. As discussed below, Powell may prove to be the decision that awakened the sleeping lion of Section 2036(a)(2). Indeed, Powell's effect on unsuspecting wealthy families generally should be the focus of clients, estate planners and commentators."*
        iii. 2704 Regs that would have restricted/eliminated discounts were withdrawn. Steven T. Mnuchin, Report to the President on Identifying and Reducing Tax Regulatory Burdens, Executive Order 13789 (October 2, 2017), available at https://www.treasury.gov/press-center/press-releases/Documents/2018-03004_Tax_EO_report.pdf.
        iv. "*The "sword" of Section 2036(a)(2) may be countered with the "shield" of the bona fide sale for adequate consideration exception under Section 2036(a). To define this exception, Treas. Reg. Section 20.2036-1 directs the reader to Treas. Reg. Section 20.2043-1, "Transfers for Insufficient Consideration," which explains that "to constitute a bona fide sale for an adequate and full consideration in money or money's worth, the transfer must have been made in good faith, and the price must have been an adequate and full equivalent reducible to a money value.""*
        v. Powell first Application of 2036(a)(2) to LP interests.
            1. in Strangi and Turner cases decedent was a GP or owned interests in GP
            2. Powell is the first case to apply Sec 2036(a)(2) when decedent owned only a LP interests.
    b. Kimbell case.
        i. Kimbell v. U.S 371 F.3d 257 (5th Cir. 2004).
        ii. The pro rata interest in the FLP that taxpayer received was not adequate consideration for the assets she transferred to the FLP. Instead, it was a paper transaction resulting in a mere "recycling of value."
        iii. What is required for the transfer by Mrs. Kimbell to the Partnership to qualify as a bona fide sale is that it be a sale in which the decedent/transferor actually parted with her interest in the assets transferred and the partnership/transferee actually parted with the partnership interest issued in exchange. In order for the sale to be for adequate and full consideration, the exchange of assets for partnership interests must be roughly equivalent so the transfer does not deplete the estate.

iv. Transaction between family members, it is subject to heightened scrutiny to ensure that the sale is not a sham transaction or a disguised gift.
v. The Fifth Circuit explained that the district court failed to separately analyze the two requirements for the bona sale exception, which are: (1) whether the transaction qualifies as a bona fide sale and (2) whether the taxpayer received full and adequate consideration.
    1. The facts to determine whether Ruth satisfied the first prong (a bona fide sale). They expressly noted: (1) Ruth retained sufficient assets outside of the FLP for her own support and there was no commingling of the FLP and her personal assets; (2) partnership formalities were satisfied and the assets contributed to the FLP were actually assigned to the FLP; (3) the assets contributed to the FLP included working interests in oil and gas properties, which do require active management; (4) and several credible and unchallenged nontax business reasons were advanced for the formation of the FLP that could not be accomplished via Ruth's revocable trust (i.e., a revocable trust did not provide legal protection from creditors the way a limited partnership would).
    2. Whether a transfer to a partnership is for adequate and full consideration is: (1) Whether the interests credited to each of the partners was proportionate to the fair market value of the assets each partner contributed to the partnership, (2) whether the assets contributed by each partner to the partnership were properly credited to the respective capital accounts of the partners, and (3) whether on termination or dissolution of the partnership the partners were entitled to distributions from the partnership in amounts equal to their respective capital accounts.

c. Strangi case.
    i. Strangi v. Comm., T.C. Memo. 2003-15, aff'd, 417 F.3d 468 (5th Cir. 2005).
    ii. What is required for the transfer by Mrs. Kimbell to the Partnership to qualify as a bona fide sale is that it be a sale in which the decedent/transferor actually parted with her interest in the assets transferred and the partnership/transferee actually parted with the partnership interest issued in exchange. In order for the sale to be for adequate and full consideration, the exchange of assets for partnership interests must be roughly equivalent so the transfer does not deplete the estate. In addition, when the transaction is between family members, it is subject to heightened scrutiny to ensure that the sale is not a sham transaction or a disguised gift.
    iii. "…the tax court held that the property transferred to SFLP by Strangi was includable in his estate because Strangi retained the right to designate who could enjoy property and income from SFLP and the GP within the meaning of Section 2036(a)(2). The court noted that SFLP could be dissolved and liquidated upon a unanimous vote of the LPs and the GP and, therefore, Strangi could act together with other shareholders of the

GP and SFLP's LPs to revoke SFLP and accelerate present enjoyment of the partnership's assets. Moreover, Strangi held the right, in conjunction with one or more other directors of the GP, to declare dividends."

iv. The Fifth Circuit explained that the district court failed to separately analyze the two requirements for the bona sale exception, which are: (1) whether the transaction qualifies as a **bona fide sale** and (2) whether the taxpayer received **full and adequate consideration**.

v. **Comment**: In Powell, the court found the decedent retained power to direct enjoyment of the property. To do so, the court relied on Strangi v. Commissioner, 417 F.3d 468 (5th Cir. 2005). In Strangi, the decedent owned a 99% limited partnership interest in a family limited partnership. The decedent then created a corporation to be the general partner. The decedent owned 47% of the stock in the corporation. The tax court found the decedent held a retained interest in the family limited partnership under §2036(a)(1) by retaining possession or enjoyment of the property and the 5th Circuit Court of Appeals affirmed. The tax court in Powell extended the reasoning of Strangi to §2036(a)(2) by stating the decedent retained the power to direct the possession or enjoyment of the property along with her children who were the other partners in the family limited partnership.

d. Bongard.
   i. Bongard v. Comm'r 124 T.C. 95 (2005).
   ii. The Bongard court looked at the above tests and stated: In the context of family limited partnerships, the bona fide sale for adequate and full consideration exception is met where the record establishes the existence of a **legitimate and significant nontax reason** for creating the family limited partnership, and the transferors received partnership interests proportionate to the value of the property transferred ... . The objective evidence must indicate that the nontax reason was a significant factor that motivated the partnership's creation ... . A significant purpose must be an actual motivation, not a theoretical justification."

e. Powell Facts.
   i. The following fact summary was adapted from ABA E-Report, "Estate of Powell v. Commissioner, 148 T.C. No. 18" By Ray Prather, Esq. and Martin Shenkman, Esq. and not from the speakers' outline.
   ii. In Powell, the decedent's son made several common and basic mistakes when planning his mother's estate. While there was It's no surprise that the Tax Court ruled against the estate. However, what is surprising is the Tax Court's reasoning on at least one point was novel. After summarizing the case, this article will discuss the basic mistakes made in planning the decedent's estate, including misusing a power of attorney, engaging in aggressive last-minute planning, and running afoul of IRC §Section 2036; and then move to the tax court's opinion by discussing how the court used this case to extend IRC §2036(a)(2) to limited partnership interests and to open the door to a future case allowing double taxation.

iii. Nancy Powell died on August 15, 2008. Her son Jeffrey Powell began his mother's estate planning a mere nine9 days earlier, on August 6, 2008. First, he created a limited partnership, NHP Enterprises LP ("NHP"), naming himself as general partner. Next, he transferred about $10 million in cash and securities from his mother's revocable trust to NHP in exchange for a 99% limited partnership interest.

iv. On August 7, Jeffrey obtained a doctor's note that allowed him to act as agent under his mother's durable power of attorney for property due to his mother's incapacity. He used the power of attorney for property to create a charitable lead annuity trust ("CLAT") and transferred the 99% limited partnership interest to the CLAT. The CLAT paid the annuity interest to the Nancy H. Powell Foundation for the remainder of his mother's life. The CLAT named Jeffrey and his brother as remainder beneficiaries upon his mother's death.

v. The power of attorney Jeffrey used contained two significant provisions related to this transaction. First, Jeffrey had the power "'[t]o grant, convey, sell, transfer, mortgage deed in trust, pledge and otherwise deal in all property real and personal, which the principal may own.' The POA also authorized Mr. Powell '[t]o make gifts on the principal's behalf, including, but not limited to, forgiveness of loans, to a class composed of the principal's children, any of such children's issue, or any or all to the full extent of the federal annual gift tax exclusion under Internal Revenue Code Section 2503(b) or any successor statute.'"

vi. Jeffrey later filed a gift tax return for the transfer to the CLAT. He determined the value of the 99% limited partnership interest to be $7.5 million after a 25% discount for lack of marketability and lack of control. This resulted in a gift to the reminder beneficiaries of just over $1.6 million. The IRS issued deficiency notices for the gift tax return and the estate tax return.

vii. The tax court determined that the assets gifted to the CLAT were includable in the decedent's estate under IRC §2033 (property in which decedent had an interest) or IRC §2038 (revocable transfers) because Jeffrey exceeded his authority granted under the power of attorney when making the gift. The underlying cash and securities transferred to NHP for the limited partnership interests were includable in the estate under IRC §2036(a)(2) (transfer with right to designate enjoyment of the property) because the decedent had the ability, when acting along with her sons, to dissolve NHP. The Tax Court found that the exception in IRC §2036 (transfers for full and adequate consideration) did not apply in this case because Jeffrey had no significant nontax reason for the transfer. And the court also found the cash and securities could be includable under IRC §2035 (certain gifts within 3 years of death). To prevent the double taxation that would have occurred by including the gifted NHP interests and the underlying assets transferred to NHP in the estate, the court found that IRC §2043(a) (allowing an estate to exclude the consideration

received for an IRC §2036 or §2035 transfer) applied to the estate tax return.

viii. The decedent's son made several basic mistakes in this case. While many estate planners will quickly recognize these errors, they are still common mistakes worth reviewing. Therefore, the analysis of this case begins with a review of these lessons every estate planner should take away from the case before we move to addressing the more complex aspects of the tax court's opinion.

ix. The first mistake in Powell, is an issue something estate planners see too frequently, agents exceeding - abusing the grant of authority under a gift provision in a powers of attorney for property. Here the decedent's son used a power of attorney that granted him the power to make gifts of up the $14,000 annual gift exclusion to the principal's family members, to make a gift of $7.5 million to his family and his mother's private foundation.

x. Many of the more sophisticated estate planning techniques require time to implement. Compressed planning might implicate a step-transaction doctrine challenge. This issue has been explored in many prior cases. For example, in Pierre v. Commr. 133 TC No. 21, No. 753-07, 8/24/09) the taxpayer gave 5% of an FLP and sold 45%. The taxpayer's valuation expert set a 45% discount on FLP interests. Since the IRS said both transfers were made the same day to the same transferee it was really equivalent to a transfer of a 50% interest which should not be afforded that discount. The Tax Court agreed, reasoning that transfers on the same day when nothing of tax significance occurred between the transfers, should be aggregated. In Holman v. Comm'r, 130 T.C. No. 12 (May 27, 2008) only eight days has passed between funding and transfers of partnership interests. The IRS argued it occurred eight days earlier and it was contemplated that gifts would be made. The IRS said the gifts and funding should be collapsed. The Court said that volatile nature of stock means there is tax independent risk during that time period because of a volatile public stock. In Gross v. Comm'r, TC Memo 2008-221, 96 T.C.M. (CCH) 187 (Sept. 29, 2008) 11 days passed and the assets were a mixed portfolio. In Senda v. Comm'r, TC Memo 2004-160 (July 12, 2004) entity interests were transferred at same time that the entity was funded and the IRS position was underlying assets given. In Linton v. United States, 638 F.Supp. 2d 1277 (W.D. Wash. 2009) and Heckerman v. United States, U.S. Dist. Ct., Cause No. CO8-0211-JCC (W.D. Wash. July 27, 2009). There was same day funding of partnerships and transfers of interests. Documents were figuratively all signed on the same table.

xi. While there are no hardline rules in terms of the time periods between different stages in a plan being effectuated, few practitioners find surprising that the nine-day time period in Powell helped to undermine the plan.

xii. In Powell, the older generation has already ceded control through the power of attorney for property, and the decedent's incapacity negated

many of the often-stated business purposes described above. Also, the decedent's two children's contribution of property to the limited partnership consisted of unsecured promissory notes – a fact that led the concurring opinion to conclude the limited partnership was merely an alter ego for the underlying assets, and as such should not be recognized.

f. Speaker's summary: "*The IRS argued that Section 2036(a)(2) applied to the transfer because of Nancy's ability as an LP, acting in conjunction with her sons, to dissolve NHP and thereby designate who would possess the transferred property or income from the property. The IRS claimed that the bona fide sale exception did not apply because the estate failed to demonstrate a significant nontax purpose for the creation of NHP and because, in light of the claimed valuation discount, the transfer was not made for full and adequate consideration.*"

g. Consider Cahill expansion of Powell.
    i. The Sec. 2036(a)(2) "in conjunction with" argument used in Powell was recently also applied in a non-partnership split-dollar case in Estate of Cahill v. Comm. T.C. Memo. 2018-84 (June 18, 2018).
    ii. **Comment**: Cahill was recently settled with the taxpayer agreeing to all IRS positions on the economic benefit split dollar advance valuation. But practitioners should note that both Powell and Cahill were bad fact (perhaps very bad fact) cases. See Lee Slavutin, Richard Harris & Martin Shenkman - Intergenerational Split Dollar - Recent Adverse Decisions in Morrissette and Cahill, Where Do We Go from Here? LISI Estate Planning Newsletter #2651 (July 17, 2018) at http://www.leimbergservices.com; and Lee Slavutin, Richard Harris and Martin M. Shenkman: Intergenerational Split Dollar – Cahill Case Settled – Taxpayer Concedes on Split Dollar Valuation Issue, LISI Estate Planning Newsletter #2663 (September 13, 2018), at http://www.leimbergservices.com .
    iii. Comments in this section of the outline are based on the author's LISI articles not the speakers' outline which we will return to below to present their recommendations and analysis.
    iv. Split-dollar cases. There are three current cases. Cahill has settled and we are waiting to hear from the other two.
        1. Estate of Clara Morrissette.
        2. Estate of Richard Cahill.
        3. Estate of Marion Levine.
    v. In 2018, in the Morrissette and Cahill cases, the taxpayers asked the Court to rule, in partial summary judgment motions, that Sections 2036, 2038 (in Cahill) and 2703 (in Cahill and Morrissette) do not apply to the valuation of the decedent's interest in the IGSD plan for estate tax purposes. In June 2018, the Tax Court denied the motions in both these cases. These are potentially significant victories for the IRS. In fact, some commentators have speculated that these cases, on the heels of the Powell FLP case, might begin to signal a shift in the Tax Court to a more pro-IRS, less taxpayer friendly, environment.

vi. Cahill facts.
    1. The donor's revocable trust, the "Richard F. Cahill Survivor Trust" (referred to as the "Survivor Trust" in the case) contributed $10 million in premiums in one year to purchase $79.8 million of life insurance on the donor's son and daughter-in-law under the IGSD plan.
    2. The policies were purchased in 2010.
    3. The donor died in 2011.
    4. At the date of the donor's death the total cash value of the policies was $9.6 million.
    5. The donor's estate was entitled to a repayment equal to the greater of cash value or premiums paid.
    6. The estate claimed that its repayment would occur many years in the future because the ILIT would never agree to terminate the split dollar plan before the death of the insured children.
    7. If we assume the children are in their 60's and have a life expectancy of 25 years, the future repayment must be discounted to a present value over 25 years. The discount valuation methodology is beyond the scope of this article.
    8. The estate claimed the discounted value of the future repayment was $183,700, which is 1.9% of the cash value. If the discount was calculated solely on the basis of time value of money, then the 98% discount is equivalent to a 17% discount interest rate compounded over 25 years.

vii. Additional bad facts in Cahill.
    1. The economic benefit split-dollar arrangement was affected by taxpayer's son, the primary beneficiary of the plan, in his capacity as trustee of the father's revocable trust (Survivor Trust).
    2. At the time the plan was implemented the 90-year-old father could not manage his own affairs. This is similar to Powell and other cases which were classified as bad fact cases where the planning was done by the child/heir after the parent/benefactor was not competent.
    3. The Cahill plan was structured with an ILIT that had son's cousin and business partner as the sole trustee. Thus, there was no independence on either side of the transaction. This might be particularly relevant in Cahill because of the lack of economic substance to the transactions.
    4. There appeared to be limited non-tax purpose for the insurance component of the transaction. However, the estate may well endeavor to argue this point at trial to attempt to deflect the 2036, 2038 and 2703 challenges. The business purpose in Cahill contrasts with Morrissette, which had what some view as a more substantial non-tax purpose of protecting a family business, although based on the recent denial of summary judgement on 2703 it is not yet clear whether that business purpose will suffice to

salvage the intended result. In Cahill, the son claimed the insurance was to facilitate succession of his business to his children which had nothing to do with G-1 and the purported business purpose did not seem to have any weight in the eyes of the Court.

5. The IGSD plan could be terminated during the insured's lifetime by agreement between Survivor Trust and ILIT. This effectively had the son and primary beneficiary of the plan, and his cousin/business partner controlling the decision.
6. The cash surrender value of policy at the father's death was substantial, $9,611,624. The valuation of the IGSD at approximately 98% discount from the CSV was significant.
7. The life insurance policies guaranteed 3.0% on the invested portion of premiums. Also, the return on the policies over the long-term was apparently less than the cost of the loan so that there was a negative economic result from inception, and this was exacerbated by the fact that the loan was only for five years when life expectancy was dramatically more, only further corroborating the potential lack of sustainability of the transaction.
8. The Cahill estate maintained it was not likely that the arrangement would be terminated. But this contention was contradicted by the negative arbitrage on the cost of the loan from Northern Trust and the return on the underlying policies, and on the disconnect between a five-year loan and a supposed long-term plan.
9. The transaction may not have been economically viable for the long term:
    a. Loan term was for five years.
    b. Northern Trust did not have to renew the loan.
    c. The loan interest rate may have exceeded the guaranteed rate of return on the policy cash value.
10. The father guaranteed the loan.
11. At death of insured, repay the greater of the: (1) loan and/or the (2) premiums paid, or (3) cash surrender value. The IRS position was that this, combined with the right to terminate the plan, is in part what warrants the inclusion of the cash value of the policy in the estate, if the restrictions in the IGSD arrangement can be disregarded under Section 2703.
12. The ILIT did not provide consideration for the IGSD arrangement including the rights to death benefits under the three policies.
13. If agreement is terminated and ILIT retains the policy, it must pay the Revocable Trust/Survivor Trust greater of cash surrender value or premium paid.

viii. 2036 and Cahill.

1. Code Sec. 2036 can apply to include in the value of the gross estate the value of:
    a. All property that the decedent had transferred during lifetime [The Cahill Court viewed the transfer of the

premium payments from the Survivor's trust (the decedent's revocable trust) to the ILIT as constituting the property transferred],

b. Over which the decedent retained for life the right, alone or in conjunction with another person, to designate the person or persons who shall possess or enjoy the property or the income therefrom. The Cahill Court viewed the right of the Survivor's Trust and the ILIT together to terminate the IGSD agreement as the right "in conjunction with another" to designate who would enjoy the property, i.e. the cash value resulting from the premiums paid.

2. To what extent do the facts in Cahill support such a position? Does the fact that the son orchestrated the plan, and that the son as trustee of the revocable trust and executor, could "in conjunction with" his cousin/business partner, as trustee of the ILIT, terminate the IGSD, sway the Court's view? Did it further influence the Court's view that the same son (and his descendants) were the primary beneficiaries of the trust? Would having independent trustees affect the conclusions? Did the weight of other circumstances also affect the Court's view? There is perhaps another perspective.

ix. Cahill and "in conjunction with.'

1. Both Code Sections 2036 and 2038 summarized above include a requirement that the decedent could have pulled the 2036 or 2038 "strings" "alone or in conjunction with any other person." The court in Cahill focused on this requirement and noted that the decedent (really through his son as trustee of the revocable trust) had the right to terminate the split-dollar agreements in conjunction with the trustee of the MB Trust (the ILIT). That, in the Court's view, satisfied the 2036 and 2038 requirements because the two trustees could have, in the court's view, merely terminated the split-dollar agreement and the Revocable Trust would have received the cash value of the policy. The estate's counter to this was that it would not make economic sense for the ILIT to allow termination of the split-dollar agreements since that would harm the beneficiaries of the ILIT. However, the son and his descendants were the beneficiaries. The estate argued that such a termination was so unlikely that the termination rights had no value as of decedent's date of death. On this basis, the estate contended that the value of decedent's interests in the split- dollar agreements was limited to the value of decedent's death benefit rights. The difference between the two was dramatic.
2. The Cahill court quoted the Powell FLP case on the requirement of "in conjunction with": ("Decedent's ability to dissolve * * * [her limited partnership] with the cooperation of her sons constituted a 'right * * * in conjunction with * * * [others], to designate the

persons who shall possess or enjoy the property [she transferred to the partnership] or the income therefrom', within the meaning of section 2036(a)(2)." The estate tax notice quoted in the Powell case included the following three paragraphs addressing "in conjunction with."

h. Speakers conclusions on the new post-Powell "in conjunction with" world.
    i. Strangi, Bongard, Powell, (even Cahill), suggest practitioners revisit how FLPs are structured to avoid Sec 2036(a)(2).
    ii. **Comment**: Practitioners might communicate this change in atmosphere to existing clients. Practitioners might consider adding something like the following to footers on bills, firm newsletters, website blogs, etc. to notify clients.
    iii. **Sample Language to Communicate to Clients**: "You should review all existing FLP/LLC agreements, and perhaps even other planning, in light of the 2017 Powell case which was recently reinforced by the case and settlement in a split-dollar insurance case called Cahill. Even if you are below the new exemption amounts the threat of the exemption sunsetting to one-half the current amount in 2026, or being changed by future legislation, should be considered. Understand that assets transferred to an FLP/LLC could be included in your gross estate under Section 2036(a)(2) because you "in conjunction with" other persons, could determine whether and when distributions could be made to the partners/members, and the amounts of distributions. You should consider amending and restating governing documents to remove any involvement you might have in vote as to distributions, liquidations or dissolutions, and power to vote with all of the other partners for an amendment to the partnership/operating agreement."
    iv. **Comments**: The speakers' comments below are important for practitioners to consider in planning.
    v. Using FLPs to achieve estate-tax discounts is "a standard estate planning strategy."
    vi. Rethink the approach:
        1. Attention to significant and legitimate nontax purpose requirement. Example: managing operational assets, preparing for a liquidity event, etc.
        2. Ensure that any person designated as a GP in the FLP is not also designated the client's agent under a power of attorney.
        3. FLPs/LLCs should be structured so the client (even as a mere LP) should have no vote as to distributions, liquidations or dissolutions, and power to vote with all of the other partners for an amendment to the partnership/operating agreement.
        4. For clients wanting some control consider, after prohibiting the client from voting on distributions, liquidations or dissolutions, and amendment of governing agreements, the power to remove and appoint a successor trustee of a trust holding FLP/LLC interests so long as the successor trustee is not related or subordinate (within

the meaning of Section 672(c) of the Code) to the client. If the client is given a power to replace a GP or manager that should be limited with similar language/restrictions.

i. Byrum may not be an answer.
    i. United States v. Byrum.
    ii. Taxpayers may argue that retaining voting or management control over assets transferred to an FLP/LLC does not implicate Sec 2036(a)(2) based on Byrum.
    iii. Court held for Byrum's that the retention of such control did not trigger inclusion of the stock under Sec 2036(a)(2) because:
        1. Byrum's influence as a majority shareholder was not ascertainable or legally enforceable.
        2. As a majority shareholder subject to fiduciary duties to the other shareholders and directors had the same duties.
        3. Companies were operating, active businesses with real economic considerations to weigh when determining whether to declare dividends.
    iv. In typical LLC/FLP there is no operating business with economic concerns that would drive distribution decisions, and unrelated parties are uncommon.
    v. Byrum is distinguishable from the typical LLC/FLP owning marketable securities for investment of which all the partners are family members and trusts for them.

j. Speakers planning recommendations. **Comment**: The list of planning ideas offered is reproduced from the speaker's outline and provides a valuable checklist for practitioners to consider.
    i. Transfer the interests in the FLP to the client's spouse as a gift if spouse did not transfer assets to the FLP. This should avoid the gift tax by unlimited marital deduction Sec 2523, and Section 2036 should not apply to the spouse.
    ii. Transfer the interests to a QTIP. Sec 2523(f)(5)(A)(i) provides that, in the case of any QTIP property, "such property shall not be includible in the gross estate of the donor spouse," and the regulations clarify that this trumps inclusion under other Code sections, such as Section 2036.
    iii. Transfer all FLP interests to the client's children or trusts for them. Consider client needs for assets - sale may solve that.
    iv. Structure the FLP so that the class of interests held by the transferrer have no vote with respect to distributions, liquidations or dissolution, or amendment of governing agreement concerning those matters. Recapitalize the FLP. Each LP could be converted into two types of units: those that have a vote with respect to liquidations and dissolution (class A) and those that have no vote whatsoever (class B). The transferrer can then transfer his class A units in the FLP and retain the class B units.
    v. Be careful not to trigger Sec 2704(a) if voting rights are relinquished or eliminated. Sec 2704(a) treats certain lapses of voting/liquidation rights as

deemed transfers if the family controls the entity before and after the lapse.

vi. Transfer the interests to an incomplete gift trust. Trustee of the incomplete gift trust could be anyone other than the transferor/client. Voting rights attributable to the LP interests would be held by the independent trustee, Sec 2036(a)(2) should not apply to the property transferred to the FLP. No taxable transfer occurs, transferor can be a beneficiary, transferor could have a LPOA over trust exercisable during their lifetime in order to make the gift incomplete.

vii. Sell, rather than gift, the FLP interests.

viii. If the client serves as the GP of an FLP or manager of LLC, governing instrument should provide significant restrictions on the authority to make distributions (e.g., make distributions mandatory, require the consent of all members).

ix. Dissolve FLPs and LLCs before a client's death.

6. **<u>What Every Estate Planner Needs to Know About Agriculture Tax Planning</u>** - Roger McEowen.
    a. While I feel the trepidation of Billy Crystal before the long cattle drive from New Mexico to Colorado in City Slickers, Roger provides some comfort in saying: "These materials… have been prepared with the goal of providing guidance to the practitioner that does not normally (or ever) do tax work or prepare estate/business plans for clients engaged in agricultural production or other agricultural businesses." Whew.
    b. Agriculture has and does receive special legal and tax treatment. What factors determine if a particular activity is "agricultural?"
        i. What does the enterprise produce?
        ii. What resources are used in the production process?
        iii. What is the organization's economic structure?
        iv. What technology is involved in the methods of production?
        v. What is the role of the operator?
        vi. What is the relationship between the operator and the resources used in the organization and production of the product?
    c. When is the taxpayer a "farmer" so that income is reported on Schedule F and not Schedule C of Form 1040?
        i. "Farming" includes cultivating, operating, or managing a farm for profit… includes a stock, dairy, poultry, fish, fruit, or truck farm. It also includes a plantation, ranch, range, or orchard. A "farmer," for purposes of inventory and accounting methods, and estimated gross income for estimated tax purposes, is also someone who is engaged in oyster farming, the raising of bees, breeding and raising chinchillas, mink, foxes and other furbearing animals. Treas. Reg. §1.6073-1(B)(2) and Rev. Rul. 57-588, 1957-2 C.B. 305.
        ii. If the client's main source of income is from providing agricultural services such as soil preparation, veterinary, farm labor, horticultural, or management on a fee or contract basis, she is not a farmer.

iii. Differentiating farm income from rental income is important for the Sec 469 passive loss rules and the 1411 NIIT rules.

d. Special tax accounting rules.
   i. Farmers eligible for the cash method of accounting though they have inventories
   ii. Cash method farmers can sell grain, livestock and real estate on the installment method.
   iii. A shareholder of an S-Corporation engaged in farming can treat compensation received as farm income.
   iv. A farmer can exclude from income a cancelled debt that is a "qualified farm debt" owed to a "qualified person."
e. Conservation easement.
   i. Definition of a "qualified farmer" for purposes of the 100 percent conservation easement deduction of I.R.C. §170(b)(1)(E)(iv)(I). Rutkoske, et al, v. Comr., 149 T.C. No. 6 (2017),
   ii. Conservation deduction limited to 50% a computation base approx. AGI. But for a "qualified farmer" limit is 100% of contribution base, with a 15-year carryforward.
f. Leasing.
   i. Leasing important to agriculture as it permits farmers/ranchers to operate larger farms and can assist new farmers/ranchers in establishing a farming or ranching business.
   ii. Many types and variations.
      1. Cash leases - periodic payment of a rental = fixed dollars/acre, or a fixed amount for the entire farm payable in installments or in a lump sum.
      2. Flexible cash lease - cash rent fluctuates with production conditions and/or crop or livestock prices.
      3. Hybrid cash lease - specifies that the rental amount is to be determined by multiplying a set number of bushels by a price determined according to terms of the lease, but at a later date. The tenant will market the entire crop.
      4. Guaranteed bushel lease - tenant delivers a set amount of a certain type of grain to a buyer by a specified date. The landlord determines when to sell the grain and is given an opportunity to take advantage of price rises.
      5. Minimum cash or crop share lease - involves a guaranteed cash minimum. Landlord has the opportunity to share in crop production without incurring out-of-pocket costs.
      6. Crop-share leasing arrangement - rent paid on the basis of a specified proportion of the crops. The landlord may or may not agree to pay part of certain expenses.
g. Estate Planning.
   i. Active farming businesses can qualify for special use valuation Sec. 2032A(b)(5).

ii. Note - Material participation can cause problems with respect to Social Security benefits.
iii. Material participation required for five of eight years before retirement, disability or death to make special use valuation. I.R.C. §2032A

h. Self-employment tax.
i. Self-employment ("SE") tax applies to income from a trade or business. Whether the farming is a trade or business is a fact determination.
ii. Rentals from real estate and from personal property leased with the real estate are not earnings from self-employment subject to SE tax. Sec.1402(a)(1).
iii. Income from crop share and/or livestock share rental arrangements for landlords who are not materially participants not be classified as SE income.
iv. Roger's recommendations:
1. Leases should be drafted so that the landlord is not providing any services or participating as part of the rental arrangement.
2. Services/labor participation should remain in an employment agreement.
3. Leases where the landlord is also participating in the lessee entity should be set at market value for comparable land leases.
v. Farmers that lease machinery - Is income subject to SE tax?
1. "net earnings" for SE means the gross income derived by an individual from any trade or business. Rental income is reported on Schedule E Form 1040 and is not subject to SE tax. Under Sec. 1402(a)(1) "rentals from real estate" are excluded from the definition of "net earnings from self-employment."
2. "There shall be excluded rentals from real estate and from personal property leased with [in connection with] the real estate…".

i. S corporation vs. C corporation Post-TCJA for Farming/Ranching.
i. Farm/ranch clients – what is appropriate entity post-TCJA?
ii. C corporation 21%t flat tax rate vs pass-through entity and a 20% 199A qualified business income ("QBI") deduction.
iii. If existing C corp elects S status, passive income can be a problem.
iv. S corps not subject to the accumulated earnings tax ("AET") or the personal holding company ("PHC") penalty taxes.
v. S corporations with earnings and profits ("E&P") from prior C corporate tax years are subject to limitations on passive investment income. Sec. 1362.
vi. 21%t tax is imposed on "excess net" passive income if corporation has C corporate E&Ps at the end of the tax year and more than 25% of gross receipts are passive sources of income. Sec. 1375. For farm and ranch businesses, a major possible source of passive income is cash rent.
vii. If passive income exceeds the 25% limit for 3-years S-election automatically terminated. Sec. 1362(d)(3).

viii. Avoid passive income issues is for corporation to distribute all accumulated C corporate earnings and profits to shareholders before the end of the first S corporate year-end. Sec. 1375(a)(1).
ix. Make a deemed dividend election with the consent of all of the shareholders. Reg. Sec. 1.1368-1(f)(3).

j. Trusts and SE Tax.
i. Regs provide "…income derived from a trade or business carried on by an estate or trust is not included in determining the net earnings from self-employment of the individual beneficiaries of such estate or trust." Treas. Reg. Sec. 1.1402(a)-2(b).
ii. Income from a business maintained by a trust is not included in determining net earnings from self-employment of the individual beneficiaries unless there is a basis for disregarding the entity for purposes of the Code.
iii. What type of a situation would serve as a basis for disregarding the entity? Example the grantor of the trust is also the trust beneficiary. Huval v. Comr., T.C. Memo. 1985-568.
iv. Beneficiary participated in the operations and the management of the farming activity and reported income and the distributions from the trusts on her Form 1040 Schedule E where it was not subject to self-employment tax. IRS determined that QTIP trust and credit shelter trust were trusts with a separate existence so that pass-through income from the trusts was not deemed to be net earnings from self- employment to beneficiary. The trusts were not found to be business trusts whose separate existence would be ignored under the Code. However, the IRS noted that there could be an issue of whether beneficiary received adequate compensation. TAM 200305001 (Jul. 24, 2002).
v. Father died, and an irrevocable, testamentary trust created. Surviving widow and son, were trustees and beneficiaries of the trust. Trust paid a fee to son for managing the farming operation and paid a fee to widow for maintaining farm records. Son and widow reported the fees as SE income but did not report the income received as beneficiaries of the trust as subject to SE tax. IRS treated the trust as a separate entity. Earnings were not subject to SE tax. The trust was to be respected as separate entity under the Code. IRS noted that there could be an issue of whether widow received adequate payments for her services, and whether son received reasonable and sufficient payments for his management activities. TAM 200305002 (Jul. 24, 2002).
vi. Roger's conclusions from the above:
1. Trust can insulate beneficiaries from SE income on an actively conducted farming operation if:
a. Trust created to preserve the property for another party that is not merely an attempt to move business operations into a trust entity (i.e., it is not a business trust);
b. The trustees or other individuals rendering management or other services to the trust are reasonably compensated for

their services in a manner that is subject to either FICA or SE tax.

7. **Ethical Considerations in Representing Vulnerable Adults and Fraud within the Family** - Sandy Glazier.
    a. Demographics.
        i. Millions have Alzheimer's or other dementias.
        ii. As population age 65+ grows number with Alzheimer's or other dementias will increase.
        iii. Americans age 65+ to double from 48M to 88M by 2050.
    b. Elder abuse.
        i. 1 in 10 Americans aged 60+ have experienced some form of elder abuse.
        ii. Estimates 5M seniors abused each year.
        iii. Only 1 in 14 cases of elder abuse reported.
        iv. 60% of abusers/perpetrators are family members.
        v. 2/3rds perpetrators are adult children or spouses.
        vi. Almost 1/2 of those with dementia are abused/neglected.
    c. Elder abuse can result in downhill spiral for senior.
        i. Caregiver neglect and financial exploitation of the elderly had the lowest survival rates.
        ii. An episode of victimization can 'tip over' an otherwise productive, self-sufficient older person's life because older victims have few support systems or reserves.
    d. Many factors trigger abuse.
        i. Age may be a factor, but any vulnerable adults (cognitive impairments) may be subjected to financial abuse.
    e. **Comment**: For a detailed discussion on coordination issues of the efforts of all advisers in combatting elder financial abuse, see: Marty Shenkman & Sandra Glazier, "Lack of Coordination in Estate Planning Documents & the Potential for Best Laid Plans to Go Awry," LISI Estate Planning Newsletter #2576 (August 24, 2017) at http://www.leimbergservices.com, 24-Aug-17. Planning for aging (and incapacity) requires more than just the traditional preparation of a Will, durable power of attorney ('DPOA'") (and perhaps a revocable trust). The multitude of fiduciary and quasi-fiduciary appointments clients make, almost entirely without professional input, can create conflicts and inconsistencies in the administration of the client's affairs. Practitioners can provide great assistance to their clients when they expand the scope of their inquiry and client discussions to address issues relating to such appointments and the importance of coordination of fiduciaries named under primary legal documents. Doing so can forewarn the client of pitfalls that could undermine the safeguards the planning team is endeavoring to create. As estate planning remains extremely relevant in implementing client desires, it's important for practitioners to evolve and consider a broader range of practical, non-technical, considerations that can make our services beneficial to all spheres of client echelons. Agency relationships can be created in a myriad of ways. Some come about formally via specific nomination in an instrument, while others result from a repose of trust and authority in less

formal ways. It's not uncommon for "checklists" to cue us to ask who the client wants as their personal representative, trustee, agent under a general durable power of appointment, medical proxy and perhaps as trust protector, but have you considered as part of the planning process who will: (i) be empowered to make funeral arrangements; (ii) be the representative for receipt of social security benefits; (iii) have access to the client's safety deposit box; (iv) be designated as long term care insurance lapse designee; (v) have access to their tangible personal property and important documents and records; (vi) be the successor "owner" under 529 accounts; or, (vii) act as guardian or conservator for a minor or developmentally disabled adult child? Consider this as you review some of Sandy's comments following.

f. FINRA.
    i. Rules 4512 & 2165 effective 2/5/18.
    ii. FINRA defines a vulnerable client ("Specified Adult") as:
        1. Natural person age 65+;
        2. Natural person age 18+ who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.
    iii. Financial exploitation:
        1. wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or
        2. any act or omission by a person, including through the use of a power of attorney, guardianship to:
            a. obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property; or
            b. convert the Specified Adult's money, assets or property.
            c. FINRA Rule 2165(a)(4).
    iv. The new law provides immunity for good faith disclosures made with regard to suspected financial exploitation, but it doesn't mandate reporting.
    v. Financial professionals are required to obtain the name of a trusted person from their clients.
    vi. Advisers can take action and freeze a transaction or client's account for 15 business days and alert others so that additional action to protect the client might be initiated when there is a reasonable basis to suspect that financial exploitation is taking place.
    vii. Consider obtaining written authorization and direction from the client when they are competent to as to the steps the client might wish to have taken on their behalf should concerns arise down the road.
g. Lawyers and elder abuse.
    i. Attorneys can help protect clients from aging, infirmity, etc. but face a range of ethical and other rules that impact what can or should be done.
    ii. In law conflicting responsibilities are encountered. Virtually all difficult ethical problems arise from conflict between a lawyer's responsibilities to clients, to the legal system, and to the lawyer's own interest in remaining

an upright person while earning a satisfactory living. The Rules of Professional Conduct prescribe terms for resolving such conflicts. Within the framework of these rules many difficult issues of professional discretion can arise. Such issues must be resolved through the exercise of sensitive professional and moral judgment guided by the basic principles underlying the rules. Michigan Rules of Professional Conduct- Preamble, 4/28/17.

h. Who is the client?
    i. It's not uncommon, when dealing with the elderly or infirmed, for a family member to initiate contact with counsel, or bring client to meeting.
    ii. The person is generally the client, not the family member who contacted counsel or brought them to the meeting.
    iii. Caution - procurement can be an indicia of undue influence (or even an element of the presumption of undue influence in some states), it may be important to note the contact. Thereafter, to the extent possible, further contact should be directly engaged in with the client.

i. Capacity generally.
    i. If client's capacity to make adequately considered decisions in connection with legal representation diminished (minority, mental impairment, etc.) lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.
    ii. Even client has legal representative lawyer should as far as possible accord the represented person the status of client, particularly in maintaining communication and look to client not family to make decisions on client's behalf. MRPC 1.14(a\).
    iii. Lawyer should assess whether client has the capacity for proposed transaction. Doesn't mean administering mini-mental exam (MMSE). Lawyer may observe:
        1. Client's ability to articulate reasoning leading to a decision.
        2. Variability of state of mind.
        3. Ability to appreciate consequences of action or decision.
        4. Substantive fairness of the decision.
        5. Consistency of a decision with the known long-term commitments and values.
        6. Irreversibility of the decision.
    iv. Dementia diagnosis may reflect existence of cognitive issues such as diminished capacity and vulnerabilities, it does not necessary reflect that a client lacks the capacity to hire the lawyer or engage in estate planning transactions.
    v. **Comments**: Counsel should remember that the capacity of a client may vary over time. Depending on the health challenge the particular client's capacity may change at different times of day, how the client feels that particular day versus other days, when the client last took medications, and other factors. Cognitive fatigue common among many neurologic conditions might slow the client's speed to process but not necessarily the capability of understanding. Be cautious about generalizations especially

in light of the fact that physical appearances may not correlate with cognitive ability, e.g. Parkinsonian masked facies.

j. Capacity and Degree of capacity for various docs/acts.
    i. The capacity required differs depending on the transaction
    ii. Retaining counsel requires the contractual capacity = ability to understand nature and effect of the act and business being transacted.
    iii. Signing a will, "testamentary capacity" requires generally testator know:
        1. objects of bounty.
        2. nature and extent of his assets.
        3. capability to interrelate above elements to form a dispositive plan.
    iv. Testamentary capacity does not require testator be able to manage her own affairs.
    v. Revocable trusts require same testamentary capacity. **Comment**: Will that always be the case as the application of revocable trusts expands to focus on disability planning and hence incorporates many/all of the provisions included in a power of attorney which under some state laws might require contractual and not testamentary capacity? This is perhaps similar to the issue that revocable trusts are viewed as will substitutes and the case law (e.g. Tseng v. Tseng) that struggle to find remedies for successor trustee misdeeds while the settlor of a revocable trust remains alive. See speaker comment below concerning gifts. It is common for revocable trusts to incorporate the same gifting provisions as a POA.
    vi. Financial Power = POA generally requires capacity to contract. May require higher standard because of abuse POAs can enable ("license to steal".) Public policy may require that the principal also be able to engage in "thoughtful deliberation" and "reasonable judgment." **Comment**: See comments on revocable trust and consider if/when the higher standards that might be relevant to a POA may apply.
    vii. Health Proxy (= medical POA or designation of patient advocate) generally requires the capacity to contract, which may be higher than the actual capacity required to make the underlying medical decisions.
    viii. Irrevocable trusts generally require same capacity as that required to make a gift = understanding the nature and purpose of the gift, extent of assets given, objects of settlor/donor's bounty. Some state require that settlor/donor understand that gift will diminish donor's assets. **Comment**: What about a zeroed out GRAT? If annuity = value of gift is it a gift? What of a self-settled trust?
    ix. Deed – client must understand business transaction, nature and extent of her assets, and how she wants to dispose of it. Signer must understand above sufficiently to plan and effectuate the conveyance without prompting or interference from others.

k. Conflicts.
    i. If a conflict exists and can be waived client must have capacity to give "informed consent" = agreement by a person to a proposed course of conduct after lawyer has communicated adequate info including material risks, options, etc.

ii. If the representation of both the existing client and the new client would create a significant risk that the representation of one or both clients would be materially limited.
iii. See MRPC 1.7(b) and 1.8(f).
iv. **Comment**: Consider what is or might be in your retainer agreement: "sample provision: We reserve the right to cease representation if, in our sole discretion our representation creates a conflict or ethics issue, if your conduct is objectionable, you do not follow our advice, you seek to pursue an illegal purpose, you make a material misrepresentation, your conduct impedes our ability to represent you, or any other matter permitted."
v. Attorney should take action to protect client if believe at risk of substantial physical, financial or other harm.
vi. Weigh the potential risks of a disclosure that has the potential of injuring the client.
vii. Actions may include consulting with a family member or other individuals or entities that could take action to protect the client and, in some instances, have a guardian ad litem, conservator or guardian appointed. MRPC 1.14.
viii. **Comment**: In states where there is no mandatory reporting duty of lawyers, a lawyer's ability to report elder abuse where MRPC 1.6 may restrict disclosure of confidentiality would be governed by MRPC 1.14 in addition to any other exception to MRPC 1.6 (such as when there is a risk of death or substantial bodily harm).

l. What if suspect elder abuse?
i. Tell concerns to the client.
ii. Suggest plan with checks and balances - co-trustee or trust protector, etc.
iii. Monitor.
iv. Consulting with other professionals using hypotheticals to protect the client's confidences.
v. Notify client's agent/family of concerns.
vi. Contact adult protective services.

8. **Executor, Trustee and Beneficiary Liability for Unpaid Taxes, Penalties and Expenses of a Decedent** - Jerry August.
a. Priority of Federal Claims.
i. Federal Priority Act.
ii. Federal government claims have first priority for payment of taxes.
iii. Sec 6901(a)(1)(B) provides for the assessment, payment, and collection of the liability of a fiduciary under Sec 3713(b).
iv. Fiduciary includes: personal representative, administrator, etc. Sec 7701(a)(6). Decedent had no descendants but two nieces. One nieces refused to be appointed as executrix but signed the 706. She was held liable. Estate of Gudie v. Comm'r, 137 TC. No. 13 (2011).
v. When FPA applicable fiduciary liable to the extent of payments made in derogation of the government's priority.
b. Knowledge.

i. For executor to be personally liable must have had knowledge/notice of the debt due to IRS when the estate had sufficient assets to pay. The law firm's knowledge was imputed to their clients.
ii. Executor can only incur personal liability for making disbursements to others if had knowledge or notice of a claim of IRS before making distribution. The Want v. Comm'r, 280 F.2d 777 (2nd Cir. 1960);

c. Statute of limitations
   i. 6 years.
   ii. Runs from date IRS action accrues against the insolvent debtor's representative.
   iii. When fiduciary status ends fiduciary should give notice, the fiduciary capacity has terminated. Sec 6903(a).

d. Executor liability.
   i. Executor liable to pay federal estate tax with respect to estate and any unpaid gift tax of decedent. Reg. Sec. 25.2502-2
   ii. Executor can be discharged from personal liability for estate taxes under Sec 6905.
   iii. "*Presumably with co-executors the liability to the government is joint and several*."
   iv. If no executor is appointed, person in actual or constructive possession of property of the decedent is liable as a "statutory executor."
   v. Executor with actual notice of unpaid tax pays other debts she is personally liable to the extent of the unpaid tax. U.S. v. Goodman, 45 A.F.T.R. (P-H) Para. 1193, (N.D. Cal. 1952).
   vi. Executor can limit personal liability by applying for discharge under Sec. 6905 and Sec. 2204; requesting prompt assessment under Sec. 6501(d); providing prompt notice of termination of fiduciary relationship under Sec. 6903(a).
   vii. Executor being discharged by surrogate court doesn't end liability for federal taxes. U.S. v. First Huntington Nat'l Bank, 34 F. Supp. 578 (SD W.Va. 1940).
   viii. Estate tax deferral over 14 years under 6166 leaves executor personally liable for that entire period.

e. Transferee liability under Sec 6324.
   i. Transferee liability of heirs and trustee under Sec. 6324(a)(2) is a special lien for unpaid estate and gift taxes.
   ii. Lien attaches to assets of estate to extent tax on 706 plus any deficiency. Reg. Sec. 301.6324-1(a)(1).
   iii. Assets of gross estate used to pay charges against the estate and costs of administration allowed by a court not subject to lien.
   iv. Donee personally liable for gift tax to extent value of gift. Any of gift assets transferred by donee released of lien and lien then attaches to after-acquired property of the donee.
   v. "*Where a trustee fails to spot a potential gift tax liability of a beneficiary who may be liable under §6324(b), under §6903 the trustee may face*

personal liability. Fletcher Trust Co. v. Comm'r, 141 F2d 36 (8th Cir.), cert. denied, 323 US 711 (1944)."

9. **Changing or Unwinding a Client's Estate Plan if there is Little or No Estate Tax Exposure** - Benetta Jensen and David Herzig.
    a. Simplifying existing plans.
        i. With reduced exemption do clients need existing structures/plans?
            1. "…, the creditor and divorce protection of trusts continue to be an important component of an estate plan."
            2. **Comment**: Many plans no longer serve their initial purpose. While many advisers have suggested that maintaining a plan might make sense given the uncertainty of estate tax law changes in the future, and the sunset in 2026 (unless Tax Reform 2.0 makes the high exemption permanent). There are other perspectives to consider as well. What might growth in the client's estate look like? Perhaps financial modeling should be completed by the client's wealth adviser before any structure is dismantled. Most structures provide asset protection, control and other benefits that may be off radar for clients looking to simplify but quite important overall. Another perspective which is important to discuss with clients is that the cost of creating the structure is a sunk cost. It is really on the maintenance costs that are relevant. What might those be and how insignificant might that be compared to the remaining benefits provided? What would the cost of recreating a structure be if circumstances change in the future? Likely substantial. In too many cases it seems that clients have unraveled structures, often without consulting all of their advisers, when in fact they would be better off using the ideas presented by this panel to improve existing structures.
        ii. Classic situation to unwind planning is estate well under exemption planning done with FLPs etc. to secure discounts that now only serve to reduce basis step up.
        iii. Many clients have more trusts/structures then needed and these might be simplified by
            1. trusts may be merged.
            2. trusts could transfer assets out of old trust to newer/better trust.
            3. trusts may be terminated.
            4. **Comment**: A common example of trust consolidation is when a client has an old ILIT and created a new SLAT, e.g., in 2012 to use exception before the feared decline from $5M to $1M. Those trusts might be quite similar. If the SLAT is a directed trust with the client named as investment advisor caution should be exercised as in that role she may be responsible for decision making concerning life insurance on her life which could present a 2042 estate inclusion issue. A solution may be to decant both the old ILIT and the somewhat old SLAT into a new directed SLAT that has a

separate investment advisor for life insurance and that role may expressly exclude the insured/client.

iv. Merging of old trusts.
    1. If trust terms do not prohibit consider UTC 417: "*[a]fter notice to the qualified beneficiaries, a trustee may combine two or more trusts into a single trust or divide the trust into two or more separate trusts, if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust."*
    2. UTC 417 comments permit merger of trusts even though not identical but some state laws require trusts have substantially similar terms some require identical terms.
    3. Merging grantor trusts with same grantor should not trigger adverse income tax consequence. Reg. Sec. 1.671-2(e)(5) - grantor of the transferring trust treated as grantor of transferee trust.
    4. "*The IRS did not view the transfer of assets from one trust to the other as a distribution or termination under IRC § 661 and should not result in the realization of any income, gain or loss under IRC §§ 661 or 662 by the transferring trusts, the new trusts or any beneficiary*." PLR 200607015.

b. Trusts remain critical. **Comment**: he speakers provided a list of non-tax trust benefits. While practitioners are not doubt familiar with all of these and more clients too often are not. This is a great reminder of the points all advisers need to educate clients about:
    i. "*Trusts allow continued asset management during disability.*
    ii. *Continued avoidance of probate for all generations.*
    iii. *Immediate availability of assets at death of senior generations*
    iv. *No interruption in investment management (In addition, depending on the cash needs and investment objectives), there may be no need to develop a new investment strategy.*
    v. *Special needs trusts. There can be automatic triggers for future generations to protect the trust estate and the special needs beneficiary.*
    vi. *Incentive trusts. Be careful with incentive provisions. Incentive provisions are simple in concept, but the potential exceptions can swallow the rule. For example, a trust that matches the beneficiary's earned income raises many questions.*
    vii. *Asset protection.*
    viii. *...There are significant income tax planning that trusts can accomplish.*
    ix. *What is the value of basis step-ups, especially for low/negative basis depreciable real estate?*
    x. *Also, assets passed outright restrict the ability of beneficiaries to enjoy their inheritances at a reasonable time in life. Instead of amortizing the use over a lifetime, outright transfers encourage more immediate use.*
    xi. *And, of course, lots of planners simply overlook the fact of life – the tax law always will change*."

c. Unwinding an old Note Sale transaction.

i. What can be done with underwater note sale deal?
ii. Renegotiation note? "… *most practitioners believed that no gift should occur when the parties renegotiated the note*."
iii. Does renegotiation violate trustee's fiduciary duties of loyalty (administer trust solely in the interest of the beneficiaries). Consider trust terms and state law. If not sufficient can you decant to a trust that has better provisions? Will that suffice?
iv. Can the trust be terminated? A recent court held termination was not permitted as violative of the trustor's intent in creating the trust. Although the bennies agreed to divvy up the trust assets and terminate, claiming saving trust costs would help the bennies, the court said no. Horgan v. Cosden, 2018 WL 2374443 (Fla. 2nd DCA 2018).
v. Is there a guarantee of the purchasing trust's indebtedness to the seller? If so, how does that guarantee affect the transaction?
vi. Are there guaranty agreements that supported a prior note sale? If the note is underwater should or must the guarantee be called? If it is not called is a gift triggered? 7872 Regs provide that waiver of interest results in interest income to lender then gift to borrower if:
    1. "*the loan initially would have been subject to section 7872 had if been made without interest;*
    2. *the waiver, cancellation or forgiveness does not include in <u>substantial part the loan principal</u>; and*
    3. *a principal purpose of the waiver, cancellation, or forgiveness is to confer a benefit on the borrower, such as to pay compensation or make a gift, a capital contribution, a distribution of money under section 301, or a similar payment to the borrower*." The underlined phrase is ambiguous – not clear how much of loan principal is substantial?
vii. Consider Sec 108 re: discharge of indebtedness income. *The Senate Finance Report accompanying the passage of §108 specifically states that "debt discharge that is only a medium for some other payment, such as gift or salary, is treated as that form of payment rather than under the debt discharge rules.*"
viii. Turn off grantor trust status to end tax burn on estate. "*Be sure that the note has been paid before the conversion in order to avoid recognition of gain on the conversion and taxable income from interest payments after the conversion*."
ix. Decant into trust with tax reimbursement clause (or exercise the reimbursement clause in the existing trust that has not been used).
x. Pay note back in kind pushing assets into estate for step up and appreciation into estate to unwind the prior note sale.
xi. Intentionally trigger 2036 or 2038 estate inclusion if possible.

10. **<u>Things Every Estate Planner Needs to Know About Subchapter J</u>** - Mickey Davis and Melissa Willms.

a. Trusts are taxed as individuals except as expressly provided otherwise under Subchapter J.
b. Conduit theory of trust income taxation:
    i. Trusts pay tax on income they retain = do not distribute.
    ii. Trusts get "distribution deduction" for taxable income distributed to beneficiaries = DNI.
    iii. Beneficiaries pay tax on distributed income.
    iv. Character of pass through remains unchanged.
c. Differences between Taxable Income vs. Fiduciary Accounting Income (FAI).
    i. For general tax rules, "income" means what's taxable.
    ii. For trusts "income" contrasts with "principal" Sec. 643
d. Fiduciary accounting Income.
    i. FAI determines which beneficiary is entitled to a receipt.
    ii. Consider terms of Trust Agreement.
    iii. Consider UPIA (Uniform Principal and Income Act).
    iv. Must determine FAI to determine DNI.
    v. DNI provides rough adjustment to conform notions of taxable and fiduciary accounting income.
e. Allocating Income.
    i. Need receipt.
    ii. Is receipt principal or income?
    iii. Trust Agreement vs. State Law/UPIA = Uniform Principal and Income Act.
    iv. Receipts from entities (corps., partnerships, LLCs, etc.)
    v. Receipts from mutual funds
f. Expenses.
    i. Trust Agreement vs. State Law/UPIA
    ii. Who bears the expense – income or principal?
g. Addressing inequities.
    i. Power to adjust may allow reallocation if:
        1. Prudent investor rule applies.
        2. Amount distributed referenced as income (vs. principal).
        3. Allocation is not "fair and reasonable."
        4. To adjust economic or tax effects between current/income and remainder beneficiaries resulting from fiduciary actions.
h. Simple vs. complex trusts.
    i. Simple trusts are required to distribute all (fiduciary accounting) income at least annually. E.g. old style pay income trusts.
    ii. No distributions to charities.
    iii. No current distributions in excess of income.
    iv. Trusts that are not simple are complex.
    v. Simple trusts deduct amounts required to be distributed annually.
        1. complex trust deducts amounts required or permitted to be distributed.
    vi. Beneficiaries must report income in year required to be distributed.
    vii. Character of amounts carry out to beneficiaries.

viii. Exemptions: simple trust - $300; complex trust - $100; estates - $600.

i. Tiers.
    i. Required (Tier I) distributions carry out income first.
    ii. Treat charity as an "intermediate Tier" between Tier I and Tier II.
        1. Distributions to charities don't carry out DNI.
        2. Trusts get charitable deductions available for amounts of gross income paid to charities.
        3. Estates (and pre-'69 trusts) can deduct amounts "set aside" for charity – look to governing document
        4. 1-year "look-back."
        5. Trusts not limited to a percentage of "AGI" like individuals.
    iii. Permitted (Tier II) distributions carry out any remaining income to extent of actual distributions.
        1. Computed after considering the charitable deduction
        2. Again, generally pro rata among Tier II distributes.
        3. Distributions in excess of DNI are tax-free as corpus.

j. Estates and complex trusts can elect "65-day rule."

k. The carry-out of "distributable net income" = DNI.
    i. Exceptions to DNI carryout.
    ii. Specific sums of money or specific property paid in not more than three installments. Sec. 663(a)(1).
    iii. Requirement of ascertainability.
    iv. Terms of governing instrument on date of death.
    v. Formula bequests may not qualify.
    vi. Specific vs. general bequests.

l. Exceptions and special rules.
    i. Separate share rule.
        1. General rule DNI gets carried out to multiple beneficiaries (within each tier, if any) pro rata.
        2. Separate Share treatment applies when the governing instrument or state law creates separate economic interests in one beneficiary or class of beneficiaries such that the economic interests of those beneficiaries (e.g., rights to income or gains from specific items of property) are not affected by economic interests accruing to another separate beneficiary or class of beneficiaries.
    ii. Income from property specifically bequeathed state law/governing instrument directs if income follows the specific bequest.
    iii. Interest on pecuniary bequests state law/governing instrument directs if bequest bears interest. Interest payments are not "distributions" carrying out DNI.
    iv. Distributions in kind.
        1. Distributions of assets carry out DNI (unless a general DNI exception applies) but distributions don't generally cause estate or trust to recognize gain or loss.
        2. DNI carry out lesser of asset's FMV or basis (plus any gain recognized on distribution).

v. Distribution to satisfy debt treat as if sold asset for FMV.
vi. Distribution of appreciated property to satisfy bequest of "specific dollar amount" not same as "specific sum of money"—most formula bequests cause recognition.
vii. Executor may elect to recognize gains (and maybe losses) on distributions of property. Sec. 643(e). It's an all-or-nothing election.
As if property sold to distributees for FMV on date of distrib. Does not apply to IRC § 663 specific bequests.

m. Net losses.
i. If trust deductions exceed income excess deductions can't normally be carried back or forward.
ii. Exception for net operating losses,
1. Pre-2018 NOLs: carry back 2 years and forward 20 years.
2. Post-2017 NOLs: carry forward indefinitely (but not back), limited to 80% of taxable income.
iii. Exception for net capital losses: Non-corporate taxpayers can carry forward capital losses indefinitely
iv. Special rule in year of estate or trust termination.
1. Excess losses carry out to beneficiaries.
2. Itemized deductions carry out to beneficiaries in year entity terminates - not deductible in 2018-2025.

n. Deductibility of admin expenses for income vs. estate tax purposes.
o. Grantor trust rules.
i. Treats someone other than the grantor as owner of the trust's property for income tax purposes, applies to someone holding power to vest trust property in herself, exercisable solely by herself. E.g.: GPOA and Crummey withdrawal rights.

11. **Drafting, Understanding and Enforcing Reasonable Compensation for Trustees** - Stacy Singer.
a. Trustee duties.
i. Overseeing the use and distribution of trust assets. This might include specialized management of trust assets: total return conversion, equitable adjustment, wasting projections to help beneficiaries understand constraints and flexibility regarding distributions.
ii. Communicating with beneficiaries. Account to beneficiaries, provide info about the trust, get info on beneficiaries' needs, etc. Meet with beneficiaries to understand their lifestyle needs and support obligations, etc.
iii. Investing the trust's assets, determining investment objective based on trust terms, duration, purposes, etc.
iv. Tax reporting and filing

b. Compensation.
i. Governing trust instrument is primary authority for trustee compensation.

ii. Trustee's payment of reasonable compensation to herself is an exception to the strict prohibitions against self-dealing. Restatement of the Law (Third) of Trusts.
iii. Many trust documents and most state statutes establish a "reasonableness" standard for trustee compensation
iv. Some states have compensation based on percentage of assets included in trust.
v. Trustee compensation has been measured using reasonableness based on facts and circumstances of a given situation.
vi. Restatement provides as to "reasonable compensation" consider:
    1. Trustee's experience, skill and facilities.
    2. Local customs.
    3. If trustee has negligible active duties the statutes fixing compensation not to apply.
    4. Family relationship/friendship may be relevant.
    5. Time devoted to trust duties.
    6. Amount and character of trust assets.
    7. Degree of difficulty, responsibility, and risk assumed in administering the trust, including in making discretionary distributions.
    8. Nature and costs of services rendered by others.
    9. Quality of the trustee's performance.
    10. Amount of principal and income received and disbursed by the trustee
    11. Success or failure of the trustee's administration.
    12. Fidelity or disloyalty exhibited by the trustee.
    13. Nature of services performed - routine or requiring special skill/judgment.
vii. Uniform Trust Code ("UTC) Sec. 708.
    1. If the terms of a trust do not specify the trustee's compensation, a trustee is entitled to compensation that is reasonable under the circumstances.
    2. If the terms of a trust specify the trustee's compensation, the trustee is entitled to be compensated as specified, but the court may allow more or less compensation if:
        a. the duties of the trustee are substantially different from those contemplated when the trust was created; or
        b. the compensation specified by the terms of the trust would be unreasonably low or high.
    3. Comments to Sec. 708 - guidance provided in Sec 38 of the Restatement regarding factors to be considered in determining reasonableness, including those listed in the preceding discussion.
    4. UTC comments suggest close examination of the services actually performed, and the responsibilities assumed by the trustee. A downward adjustment of fees may be appropriate if a trustee has

delegated significant duties to agents, such as the delegation of investment authority to outside managers.

5. **Comment**: Consideration of delegation of duties seems to be too often ignored. When a layperson and often a professional (e.g. attorney) who is not an investment expert serves as trustee she delegates or hires an investment adviser to manage the trust's investments. That is likely a wise move (and get an investment policy statement). But the UTC comments suggest (and similar comments appear in the Prudent Investor Act comments) that it may be appropriate to reduce (but there is indication that any reduction should be dollar for dollar) the trustee's fees to reflect the delegation of investment management. While this is all quite fact specific, a trustee who delegates and has the trust pay for significant services that someone might construe as being a traditional duty of the trustee that would be subsumed under the trustee fee, should at least consider and corroborate whether any adjustment in trustee fees is "reasonable" based on the circumstances. It would seem that a trustee that proactively addresses and documents this matter, even if it is determine that no reduction is appropriate, would fare better than a trustee who does not address it until challenged at some future date.

c. Trustee providing and being paid for legal or other services.
    i. Restatement permits a trustee to receive compensation for rendering special services to the trust when advantageous to the trust for the trustee, rather than another, to perform those services. Examples, trustee serving as attorney or real estate agent.
    ii. Model Rule 1.8 in providing disclosure and discussing a client's options regarding selection and compensation of the attorney as fiduciary.
    iii. **Comment**: The potential problems that billing as an adviser and fiduciary can create are significant. While perhaps obvious, create separate billing accounts for professional services rendered to a trust and services rendered as a trustee. Review thee billing runs to be certain that the matters billed to the professional account are for actions that are not within the realm of what a fiduciary would be expected to do. Even though the trustee hours may not be billed because of an alternate billing arrangement, e.g. statutory fees, having both sets of time records can provide ready support for the fees charged, services rendered, and that they were differentiated.
d. Institutional trustee fees.
    i. Large trust company fiduciary fees for $5 million trust 80 to 125 basis points, inclusive of investment management services.
    ii. Institutions often use investment product which include fees such as fees associated with the management of proprietary investment products held in the trust's portfolio. UTC Sect 802(f) - accompanying payment of overlapping fees does not automatically constitute a conflict between the trustee's personal and fiduciary interests assuming disclosure of the fees is provided.

e. Termination fees.
    i. Several states expressly allow termination fees by statute.
    ii. UTC comments factors to consider re: termination fee:
        1. Actual work performed.
        2. Whether a termination fee was authorized in the terms of the trust.
        3. Whether the fee schedule specified the circumstances in which a termination fee would be charged.
        4. Whether the trustee's overall fees for administering the trust from the date of the trust's creation, including the termination fee, were reasonable.
        5. The general practice in the community regarding termination fees.

12. **Choice of Entity: Analyzing the Decision in the Wake of the New Tax Act** - Domingo Such.
    a. Family offices.
        i. Deduction for investment management expenses eliminated by 2017 Act which eliminated deductions for investment management expenses that otherwise would have been available to taxpayers under section 67.
        ii. Lender Management, LLC v. Commissioner.
        iii. New Sec 67(g) provides that "no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026." As a result, any portion of a taxpayer's expenses that previously would have been subject to the 2% floor is disallowed. The IRS has clarified, however, that section 67(e) expenses, which were not previously subject to the 2% floor, are not disallowed.

13. **Gift Return Reporting Requirements** - Christine Wakeman.
    a. Donee of gift.
        i. Trusts - a gift to a trust = gift to beneficiaries of the trust instead of the trustee of the trust.
        ii. Corporations - treated as a gift to the corporation's shareholders in proportion to their ownership interest in the company.
        iii. Partnerships - deemed a gift to its partners.
    b. Gift tax return must be filed.
        i. Gift of a future interest.
        ii. Gift to or for the benefit of any one person in excess of annual exclusion.
        iii. Gift to a non-U.S. citizen spouse in excess of annual exclusion amount for non-U.S. citizen spouses - $152,000 2018.
        iv. Split gift with spouse.
        v. Split interest gift transfers that benefit a charitable beneficiary.
        vi. Gifts to which GST exemption is to be allocated other than as provided in the automatic GST allocation rules.
    c. Non-Gift Transactions.
        i. Reporting non-gift transaction e.g. sale of a closely held entity to a trust even if no gift element.

ii. If adequately disclosed begin running statute of limitations during which the IRS can review the transaction.

d. Adequate disclosure.
   i. Adequate disclosure – must establishes all of the elements of the safe harbor rules under Reg. Sec. 301.6501(c)-1(f)(2).
   ii. Description of property transferred.
   iii. Description of property retained by the transferor.
   iv. Any consideration received by the transferor.
   v. Identity of, and relationship between, the transferor and each transferee.
   vi. Value of property transferred.
   vii. Description of method used to determine FMV of property transferred.
   viii. Financial data used (e.g., balance sheets and income statements with explanations of any adjustments) in valuing the property transferred.
   ix. Details re: use of any valuation discounts.
   x. Statement describing any position taken that is contrary to any proposed, temporary, or final Treasury Regulation or revenue ruling (if applicable).
   xi. Description of terms of trust or a complete copy of the trust instrument.
   xii. Trust's tax identification number. If the trust is treated as a grantor trust and no trust tax identification number has been obtained, then the grantor's social security number should be reported instead.
   xiii. Qualified appraisal.
      1. In lieu of detailed description of the method of calculating FMV of property transferred, submit appraisal by qualified appraiser. Holds out to public as an appraiser who performs appraisals with regularity.
      2. The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal.
      3. A description of the property.
      4. A description of the appraisal process employed.
      5. A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the analyses, opinions, and conclusions.
      6. Information considered in determining the appraised value, including financial data that was used in determining the value of the interest so that another person could replicate the appraisal process (in the case of business interests).
      7. Appraisal must follow the procedures outlined in the report and the reasoning must supports the valuation given.
      8. Indicate valuation method used (e.g., comparable sales or transactions or sales of similar interests) and the rationale for using such method.
   xiv. **Comment**: In reviewing gift tax returns prepared by others it is common to find gaps in attachments that might be necessary, or at least advisable, to meet the adequate disclosure requirements. A simple approach that helps avoid those gaps is to prepare an Exhibit list. Sometimes organizing the exhibit list by transactions being reported can be helpful to highlight

what might be advisable to attach to the return. Another point that can make the returns easier to address in future years is to consider not only what is necessary for a particular return's disclosure, but what will make it efficient in future years to more quickly ascertain what is, and is not, required to be disclosed. It seems that the general approach is merely to document precisely and solely what is needed for the current year when often with a modicum of additional information is incorporated preparation of future year's returns can be made so much easier.

14. **<u>International Wealth Transfer Planning for the Domestic Wealth Planning Advisor</u>**
    - Sean Weissbart.
        a. U.S. or foreign person.
            i. US citizen, resident alien ("RA"), or non-resident alien ("NRA").
            ii. Citizen is taxed as US person.
            iii. NRA is based on either the substantial presence test (number of days in U.S.) or Green card test.
            iv. Note that gift/estate tax definitions differ. That is based on domicile, no present intention of leaving. Facts and circumstances.
        b. Income taxation.
            i. Citizen and RA taxed on worldwide income.
            ii. NRA alien taxed on US source income.
        c. Gift and estate tax.
            i. NRA alien is subject to estate tax.
            ii. Availability of marital deduction turns on status of spouse of NRA.
            iii. Annual gift exclusion to NRA spouse is $152,000 (2018).
            iv. Marital deduction for non-citizen spouse requires QDOT.
            v. Estate tax exemption for NRA = $60,000. No gift tax exemption.
            vi. Gift and estate tax apply to transfer of any US situs asset.
            vii. NRAs are subject to US gift tax on transfers of real or tangible personal property situated in the US.
            viii. Cash may be viewed as tangible asset so US cash should not be used to make a gift. Reg. Sec. 25.2511-3(a)(1).
            ix. NRA subject to US estate tax on US situs assets which include:
                1. Real and tangible or intangible property situated in the U.S.
                2. Deposits with a US bank if effectively connected to US trade or business.
                3. Stock issued by a US corporation.
                4. Partnership interests – not clear, fact specific determination.
            x. NRA transfer tax planning.
                1. NRAs should make gift of assets that are not subject to US gift tax, but which would be subject to US estate tax, e.g. shares of stock in US corporations.
                2. Make gifts to trusts NRA can still receive benefit from and planned to avoid adverse US estate or income tax consequences.
        d. Trusts.
            i. Determine whether foreign or domestic.

ii. Trust is domestic and taxed as US person Reg. Sec. 301.7701-7(a), if:
    1. US court is able to exercise primary supervision over the administration of the trust (the "court test"). This means a US court has primary authority over the trust, and
    2. One or more US persons have authority to control all substantial decisions of the trust (the "control test"). If an NRA can control any substantial decision this test is failed, and the trust will be foreign. Substantial decisions for this test are delineated in Reg. Sec. 301.7701-7(d)(1)(ii). Examples: "….*distribution decisions, investment decisions and whether to terminate the trust, but also includes other powers such as the power to remove, add or replace a trustee, and the power to appoint successor trustees (unless this power is limited so that the appointment of the successor cannot change the residency status of the trust*)."
iii. A "foreign trust" is any trust that is not a domestic trust.
iv. Taxable income of a non-grantor foreign trust will generally be computed in the same manner as if the assets were held by the NRA directly.
v. If distributions made by foreign non-grantor trust carries out distributable net income ("DNI") US beneficiaries include the income on their individual income tax returns and the trust gets a deduction for the amount distributed to the beneficiary.
vi. Capital gains are generally not included in DNI of a domestic trust but are included in the DNI of a foreign trust.
vii. If no distributions made by foreign trust concepts different then taxation of US trust apply. If income accumulated in foreign trust it is characterized as undistributed net income ("UNI"). Distributions of UNI = "accumulation distributions" taxed as ordinary income (even if capital gain) and subject to throwback rules which can subject the amounts to interest charges based on period from when income was earned later distributed

e. Foreign corporation ownership.
    i. Citizens and residents directly or indirectly owning interests in foreign corporations classified as CFCs or PFICs may be subject to anti-deferral rules. Indirect ownership – e.g. US personal is beneficiary of foreign trust which owns shares in foreign corporation. These can result in US income tax on share of the foreign corporation's earnings and profits ("E&P"). Rationale is to prevent deferring/avoiding US income tax by use of foreign corporations.
    ii. CFC = controlled foreign corporation. CFCs have one or more US persons owning at least 10% of the total combined voting power of all classes of stock, and US shareholders own more than 50% of total combined voting stock or more than 50% of the total value of the stock of the corporation. use income.
    iii. PFIC = passive foreign investment companies. PFICs have 75%+ gross income passive, or 50%+ of its assets produce or are held for the production of passive income

f. Corporate.
    i. "*TCJA, the U.S. moved closer to a so-called "territorial" corporate tax system, by which the United States would only tax the corporate income earned within its borders. To accomplish this, the TCJA enacted Section 245A of the Code, which provides many domestic corporations with a dividends-received deduction from distributions from their foreign subsidiaries provided the U.S. parent was at least a ten-percent shareholder*."
    ii. 2017 Act changed planning for use of blocker corporations for NRAs seeking to avoid US estate tax by having US situs assets held in a foreign corporation.

g. Reporting.
    i. Various reporting requirements for foreign assets that can trigger severe penalties if missed.
    ii. Statement of Specified Foreign Financial Assets - Form 8938 - for US persons who have certain foreign financial assets.
    iii. Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts - Form 3520 – Use to report gifts, bequests or distributions from foreign persons, trusts or other entities.
    iv. Information Return of US Persons with Respect to Certain Foreign Corporations - Form 5471 – filed by officers, directors or shareholders of certain foreign corporations.
    v. Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund - Form 8621.
    vi. Return of US Persons with Respect to Certain Foreign Partnerships - Form 8865.
    vii. FBAR Form mandated by Fin Cen.

15. **<u>Preparing the 706: Traps, Mistakes and Omissions</u>** - George Karibjanian.
    a. Who signs 706.
        i. The Executor as defined in Sec. 2203 - the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of property of decedent.
    b. Valuation considerations.
        i. "*The preparer must resist the temptation to overvalue …[assets] in an attempt to receive a larger stepped-up basis for the recipient because of the accuracy-related penalties that can apply for income tax purposes under §6662(b)(3). This is especially true with nontaxable estates (e.g., where the estate owes no tax because of the marital deduction) since the overvalued stock or bond does not result in additional estate tax.*"
    c. Portability.
        i. A 706 solely to elect portability may qualify for simplified reporting if certain requirements are met.
        ii. This allows executor to estimate FMV of certain assets included in the gross estate.

iii. Note that the default on the return is electing portability so if that is not desired affirmative steps must be taken to elect out.
iv. **Comment**: Executors should consider whether an appraisal, perhaps done at a lower cost with lesser analysis, should nonetheless be obtained to establish income tax basis and to address possible concerns of beneficiaries. Note also, Estate of Sower v. Commr, 149 T.C. No. 11 (2017), the Court held IRS can review the estate tax return of a predeceased spouse to determine the correct amount of DSUE.

d. Alternate valuation date ("AVD").
   i. The executor may elect to value estate assets at their value as of the date that is six months after the date of death if the election will decrease both the value of the gross estate and the total estate and GST taxes due after applying all allowable credits. **Comment**: A tax decrease has to occur so with the current high exemptions and so few taxpayers being subject to estate tax this is unlikely. However, after sunset, it may become more common.
   ii. Election is irrevocable.
   iii. Assets sold or disposed prior to the 6-month date are valued as of sale or disposition.
   iv. Assets not sold or disposed prior to the 6-month date are valued on the 6-month AVD.
   v. IRAs and retirement plans present complexity.
      1. If estate is beneficiary AVD applies on any distributions from the estate.
      2. If 3rd person is beneficiary IRA does not leave the gross estate until transfer to beneficiary occurs.
   vi. Joint Property with Survivorship assets AVD is date 6 months after decedent's date of death or earlier date of disposition by the surviving joint tenant.
   vii. **Comment**: With the economy and market still booming the applicability of AVD is rare, but cycles will return and no doubt the use of AVD will again be more common. See Sidney Kess & Martin M. Shenkman, "Alternate Valuation," Estate Planning Review (CCH), March 19, 2009, page 19.

e. 6166 estate tax deferral.
   i. If decedent's estate includes an interest in a closely held business value exceeding 35% of the adjusted gross estate executor can elect to pay estate taxes in installments over 14 years.
   ii. **Comment:** Consider possibility of lien, etc.

f. Discounts.
   i. Question 11 requires disclosure of any discounts taken with respect to the value of the identified interest. Example, decedent owned interest in LP, close business, or fractional interest in realty, etc.
   ii. Comment: What if anything should be disclosed if decedent owned such an interest and the estate is claiming no discount? Will this evolve as so

many estates have an incentive to take a position contrary to the rationale behind this question appearing on the return?

g. Trust disclosure.
    i. Trusts created by someone other than the decedent may have to be disclosed on Schedule F if decedent possessed a power, beneficial interest, or trusteeship over the trust.
    ii. **Comment**: As more trusts include POAs to get basis step up more should be disclosed if a return is required to be filed. But if not?

h. Transfer of business interest disclosures.
    i. Line 13e require disclosure if decedent transferred or sold interests in LP, LLC, close corp, to a trust.
    ii. "*The purpose for this question is to cause the reporting of closely-held interests to, say, an intentionally defective grantor trust. If the transaction had already been reported on a Form 709 and the statute closed, then this question, while required, is meaningless. If, however, the transaction has NOT been reported on a Form 709, here is the chance for the Service to review the transaction*."

i. Partition costs.
    i. "*The distinguishing characteristic of an undivided interest in real estate is the interest can generally be partitioned and sold, giving the owner a degree of control, in contrast to a partial interest in an asset such as closely held corporate stock, in which a minority shareholder has little ability to force a liquidation of the corporation or a redemption of his interest.*
    ii. *For the most part, the Service will focus on the partition costs in connection with determining the discount. Courts, however, tend to examine the facts and circumstances of the particular case.*
    iii. *Compare: 44% discount in Estate of Williams, TC Memo 1998-59 (1998) (rejecting the Service's 5% partition cost discount), versus 17% discount in In re Ludwick, TC Memo 2010-104 (2010) (solely based on partition costs).*"
    iv. **Comment**: There has been much talk in the professional literature about liquidating FLPs and LLCs to avoid discounts. While the risks of sunset, loss of control features provided by the entity, loss of asset protection benefits of the entity, and other factors all warrant consideration, the above comments from the speaker's outline are critical to have on radar. If real estate is held in an LLC and there would presumably be discounts, liquidating the LLC and losing the above benefits to gain a better basis step-up might still seem warranted to some clients. But what bigger basis step up will actually be realized if a 44% partition discount is nonetheless applicable?

j. Valuation of Notes.
    i. **Comment**: The valuation of split-dollar economic benefit advances received considerable attention in the Cahill case and the Morrissette and Levine cases are still pending. Cahill settled, on the split-dollar matter, very unfavorably to the taxpayer. This was written up in several articles in

LISI. It is interesting to note that in the Cahill settlement the Joint Stipulation of Settled Issues filed with the tax court, items 3-10 in the settlement related to what appear to be discounted notes on which the IRS settled with the figures as reported. One of those paragraphs is: "With respect to adjustment item number 18 in the SND described as Schedule G, "Note Receivable," respondent concedes the value is $484,000 as reported on the estate tax return."

ii. The FMV of notes, whether secured or unsecured, is presumed to be the amount of unpaid principal plus accrued interest.

iii. "Reg. Sec. 20.2031-4, the note may be discounted if the executor can establish the value should be lower (e.g., due to a lower than market interest rate or an extended date of maturity), or the note is wholly or partially worthless and the value of collateral securing the note is inadequate.

iv. Rev. Rul. 67-276 sets forth the IRS's policy in determining the value of mortgages owned by a decedent at the date of death by discussing the evidence that the executor can furnish to rebut the presumption that the value of the notes is face value. Factors include the valuation of real estate, any collateral covered by the mortgages, arrears in taxes and interest, gross and net rentals, foreclosure proceedings, assignment of rents, prior liens or encumbrances, present interest yield, over-the-counter sales, and bid and ask quotations.

v. *If valuing at lower than the face value, the executor should attach a statement explaining the basis for the discount and detailing the calculation of the amount of discount claimed*."

k. Schedule F.

i. **Comment**: The speaker's outline has the following suggestion, a point for which we have all seen oddities. A good reminder not to dispense with reason when muddled in technicalities of the 706 return.

ii. "*Because this is the "everything else" schedule, the risk of reportable items being accidentally omitted is greater for Schedule F than for any other schedule. The preparer should follow the same consistency principle that estate tax examiners do. For example, does it make sense for an expensive home to be furnished with $1,000 of furniture? Should the estate of a wealthy owner of a clothing boutique report little or no clothing and jewelry? Should the estate of an electrical engineer report something in the way of electronic gadgets (e.g., multi-media equipment or computers)?"*

16. Digital assets.

i. Intangible assets are difficult to value and are becoming increasingly common and relevant.

ii. Digital assets that are online business enterprises should be valued by a qualified appraiser.

iii. Some digital assets, such as blogs with advertising revenue, Bitcoin or PayPal accounts, have economic value.

iv. Monetary value can also be found in a small business that keeps orders and invoices in a password-protected electronic program. An iTunes or Amazon account may have value through the massive amount of songs or e-books a user has purchased over their lifetime, which may or may not be transferable to other user accounts and may have a significant value to the estate.

v. Virtual Currency - IRS Notice 2014-21 provides FAQs on the tax treatment of virtual currency, such as Bitcoin.

17. **Is Charitable Giving Tax Motivated or Not**? - Sandy Schlesinger.

a. 2017 Tax Act changes affect charities and charitable planning.

i. Standard deduction increased to $24,000 for married taxpayers filing jointly ("MFJ") eliminating most itemizers.

ii. Repeal phase-out of itemized deductions ("PEASE" limitation).

iii. AGI limit on cash contributions to publicly charities and private operating foundations (but not private foundations that are not operating) increased from 50% to 60%. New Code Section 170(b)(1)(G)(iii).

1. There is some uncertainty/confusion as to the application of this rule which Sandy addressed as follows:

2. *"…coordinates the 60% limitation for cash contributions with the other limitations under Code Section 170, should be interpreted as reducing the 50% and 30% limits for the tax year in question by the aggregate cash contributions allowed under the 60% limit for such year. Thus, the cash contributions under the 60% limitation of Code Section 170(b)(1)(G) reduce the contributions taken under the other subsections of Code Section 170(b)(up to 50% of the contribution base), and as a result donors must make cash contributions in amounts that exceed their contribution basis in order to achieve a deduction that exceeds 50% of the contribution base. In other words, the cash contributions first reduce the other limits before utilizing the last 10% of the 60% limit under Code Section 170(b)(1)(G)."*

iv. Repeal deduction under Sec. 170(l) for 80% of a payment to an institution of higher education in exchange for the right to purchase tickets to athletic events.

v. The exception to the requirement to receive contemporaneous written acknowledgement of the contribution from the donee charity, if the donee reports such contribution to the Service, is repealed. Sec. 170(f)(8)(D).

vi. New Sec 4968 imposes annual excise tax of 1.4% of the net investment income of certain educational institutions.

vii. New Code Section 4960 imposes excise tax on any organization that is exempt from income taxation under Code Section 501(a) equal to 21% of any compensation paid to a "covered employee" in excess of $1M.

viii. New Sec. 512(a)(6) clarifies that for charity with more than one unrelated trade or business, the unrelated business taxable income ("UBTI") of each business should be separately calculated, and UBTI generally is the sum of

the amounts computed for each separate unrelated trade or business. Deduction from one unrelated trade or business in a tax year can' be used to offset income from a different unrelated trade or business for the same year. Sandy noted: "*On June 15, 2018 Jonathan Carter, an attorney in the Service's Office of Associate Chief Counsel, announced that the Service may postpone enforcing the new Code Section that requires tax exempt organizations to report unrelated business income for each trade or business separately, due to the possible difficulty in separating one trade or business from another trade or business*."

ix. Electing small business trusts ("ESBTs") are subject to new charitable contribution rules. ESBT contributions now are subject to rules for individuals under IRC Sec. 170. ESBT entitled to a carry-forward of charitable contributions that the trust makes in excess of the prescribed limits for a tax year and can deduct FMV of property contributed in kind to a charity, subject to percentage limitations.

b. Charitable planning ideas.
   i. High income TPs.
      1. Make substantial charitable donations will still get a deduction as likely exceed new larger standard deduction.
   ii. Lower income TPs.
      1. With modest amount may not get income tax deduction for charity if do not exceed new larger standard deduction.
      2. Bunch contributions so contributions with the amount of the taxpayer's other deductible expenditures exceed standard deduction giving TP an income tax benefit.
   iii. Create non-grantor charitable lead trust ("CLT") and transfer income producing assets to the CLT. TP's personal income would be reduced, resulting in an income tax benefit to the grantor, and CLT can make distributions to charities and deduct contributions under Sec. 642(c) without being subject to the limitations applicable to charitable contributions by individuals or the standard deduction.
   iv. Establish a donor advised fund ("DAF") transfer income producing assets to DAF. TP's income would be reduced, resulting in an income tax benefit and DAF could make contributions to taxpayer's chosen charities.
   v. TP over the age of 70.5 make transfers from IRA as qualified charitable distribution ("QDC"). IRA can transfer up to $100,000/year to public charities and distribution is not included in TP's income. QDCs count to satisfy required minimum distribution ("RMDs"). Such distributions are not included in TP's income.

18. #