

# House Planning Post-TCJA

## SALT, QPRTs, and Vacation Homes

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**A KEY ESTATE  
PLANNING GUIDE**

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# Topics of Webinar

# Topics of Webinar; References

- 1. SALT – restructuring home ownership with non-grantor trusts to salvage property tax deductions.
  - See: “Using Trusts to Enhance the Income Tax Deduction for State and Local Taxes,” Blattmachr, Shenkman & Gans. Trusts & Estates Magazine.
- 2. QPRTs – what to do with old qualified personal residence trusts.
  - See: “Post-TCJA Qualified Personal Residence Trust Planning,” CPA Journal, May 2018.
- 3. Vacation homes – TCJA changes the analysis of available options.
  - See: “Vacation Homes Post-TCJA,” Estate Planning Review—THE JOURNAL, April 19, 2018 page 68.

# **Big Picture of Current Trust Planning**

**Multiple often  
Conflicting Goals  
Must be Addressed**

# Big Picture

- Non-grantor trusts to enhance SALT deductions as discussed in depth below, and subject to restrictions in proposed Regulations, is but one component of the current trust planning environment. To make planning more beneficial, or even practical several goals should be all addressed in the same trust plan.
- The new higher exemptions are scheduled to sunset from around \$11.18 million per donor today to around \$5.6 million after 2025. It is thus a “use it or lose it” tax benefit. The exemptions may be lowered before 2025 if the political climate in Washington DC changes.
- Using the exemption to reduce the family’s overall income tax burden likely also will make good sense.
- Minimizing state income taxes.
- Permitting access to trust assets (because of the quantum of transfers possible with the new exemptions).
- Making the trust a completed gift to use the sunseting exemptions.

# **SALT Limitations: The New Rules**

**Restrictions**



# Standard Deduction – New Law

- The standard deduction under current law is \$12,700 for married taxpayers filing jointly, and \$6,350 for single taxpayers.
- The Act will increase the standard deduction to \$24,000 for married taxpayers filing jointly, and \$12,000 for single taxpayers. IRC Sec. 63 as amended by Sec. 11021 of the Senate amendment.
- The increase of the basic standard deduction does not apply to taxable years beginning after December 31, 2025. So, whatever planning is pursued must consider that this change itself might be for a limited time period.
- No standard deduction for a decedent's estate or for a non-grantor trust.
- Consider using non-grantor trusts for charitable contributions.
- SALTy SLATs might be useful to own homes to salvage property tax deductions.

# SALT Deduction Restrictions

- TCJA - deductions allowed to an individual for Federal income tax purposes for certain expenses or costs incurred have been permanently eliminated, or suspended/limited until 2026.
- Deduction for non-business state and local income, sales and property taxes limited to \$10,000 annually for individual taxpayers including non-grantor trusts through 2025. Section 164.
- Married couple filing joint - same \$10,000 limit as individual taxpayers. Married filing separately limit is \$5,000/year = significant marriage penalty.
- \$10,000 is not indexed for inflation.

# Trust Deductions Post-TCJA

- TCJA disallows miscellaneous itemized deduction under Section 67(g), the Conference Report to the Act states in part, “The ...amendment suspends all miscellaneous itemized deductions that are subject to the two-percent floor under present law.” Joint Explanatory Statement of the Committee Conference, p. 94.
- Deductions described in Section 67(e) “costs which are paid or incurred in connection with the administration of the trust or estate and which would not have been incurred if the property were not held in such trust or estate” should still be allowed.
- Those described above may be itemized deductions because they are not, by reason of Section 67(e) subject to the 2% floor. Hence, it seems that those deductions are not disallowed by Section 67(g). This conclusion seems reinforced by Treas. Reg. 1.67-4 and Knight v. Commissioner, 552 U.S. 181 (2008).

# **Non-Grantor Trusts Can Circumvent SALT Limitations**

**Each Trust Gets its  
Own SALT  
Limitation**



# Non-Grantor Trusts Can Circumvent SALT Limitations

- The use of non-grantor trusts may assist some individual taxpayers to be able to salvage Federal income tax benefits from state and local taxes, including property taxes, despite the limitation on the deduction through 2025.
- The non-grantor trust is a taxpayer, separate and independent of its grantor and beneficiaries, and is entitled to deduct up to \$10,000 annually for state and local taxes.
- The trust should also be permitted to deduct the costs of the preparation of the trust income tax return under IRC Sec. 67(e).
- The trust must have income equal to the amount of state and local taxes it pays to benefit from the deduction.
- If the individual grantor or beneficiary incurs more than \$10,000 in state and local taxes, they would in contrast get no deduction.

# Non-Grantor Trusts Can Circumvent SALT Limitations

- **Example 1:**
- Husband and Wife incur \$20,000 of property taxes, \$20,000 of other state and local taxes, \$5,000 of contributions and \$3,000 of medical expenses.
- Under prior law generally all of the deductions above \$12,000 would be deductible, or a deduction of \$36,000  $[(\$20,000 + \$20,000 + \$5,000 + \$3,000) - \$12,000]$ .
- Under current law SALT is limited to \$10,000. The itemized deductions are -0- because  $[\$10,000 \text{ SALT} + \$5,000 \text{ charity} + \$3,000 \text{ medical}] = \$18,000$  which is less than the new \$24,000 standard deduction.
- If, however, Husband and Wife gift 50% of the home to each of two non-grantor trusts, each trust, subject to the multiple trust rules under 643(f), can deduct \$10,000 of property taxes. The couple would still have the same standard deduction as they did before the transfer of \$24,000. The net result is an increase in annual deductions of \$20,000.

# Can Multiple Trusts Enhance Circumvention of SALT Limitations

- **Example 2:**
- Husband and Wife incur \$60,000 of property taxes and as in Example 1 will not realize any benefit. The couple creates six separate non-grantor trusts, each primarily benefiting one grandchild. They gift interests in the home 1/6<sup>th</sup> to each such trust. Can each trust realize a \$10,000 property tax deduction?
- The Proposed Regulations under 643(f) provide no, but it is not clear that those Proposed Regulations do not exceed the statutory authority, they are only proposed, etc. How much risk will a client be willing to accept given the 2026 sunset (unless Tax Reform 2.0 makes these changes permanent).

## 643(f) Multiple Trust Rules

- Section 643(f) provides: “For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if--(1) such trusts have substantially the same grantor or grantors **and** (2) substantially the same primary beneficiary or beneficiaries, **and** (3) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person.
- Sec. 643(f) was enacted in 1984, it was premised as applying apparently only under regulations prescribed by the Treasury and such regulations have just been issued.

# Proposed Regs on 643(f)

- The proposed regulations would establish anti-abuse rules under section 643(f) to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax, including abuse of section 199A.
- This Explanation of Provisions describes each of the proposed regulation sections.
- The Prop. Regs appear to suggest that ONE non-grantor trust is not subject to restrictions.

# What is a “Principal Purpose”

- The Proposed Regs provide:
- “(b) A principal purpose. A principal purpose for establishing or funding a trust will be presumed if it results in a significant income tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation of these separate trusts.”

# Multiple Trust Planning Suggested Before Regs

- Create a separate trust for the primary benefit of each child or other descendant, but with other descendants (and, perhaps, for asset protection reasons, also for spouses of the descendants) also as discretionary beneficiaries with no entitlement by any one of them to distributions from the trust.
- Spouses can create non-reciprocal, non-grantor, spousal lifetime access trusts (“SLANTs” or “SALTy-SLATs”), it would seem quite difficult for the IRS to challenge such trusts under any conception of the multiple trust doctrine.

# Proposed Regs on 643(f)

- While practitioners speculated about the use of multiple trusts to enhance 199A deductions the Treasury clearly read the same articles and has incorporated 643 into the proposed regulations.
- The mere use of non-grantor trusts will not provide the planning panacea some anticipated.
- Note the “**and**” requirements of the statute.
- The language in the Proposed Regulations might not facilitate using powers of appointment, different distribution standards, and other differences that had been used to break the reciprocal trust doctrine, may not suffice to differentiate trusts as some may have done before. Thus, the reciprocal trust doctrine may be avoided for several trusts but those trusts may still be ensnared by this language.
- The Prop. Reg. language may also ensnare using multiple trusts for SALT or property tax deduction and one SALT limitation may be applied.

# Example from Prop. Regs.

- Example 2. (i) X establishes two irrevocable trusts: one for the benefit of X's son, G, and the other for X's daughter, H. G is the income beneficiary of the first trust and the trustee is required to apply all income currently to G for G's life. H is the remainder beneficiary of the first trust. H is an income beneficiary of the second trust and the trust instrument permits the trustee to accumulate or to pay income, in its discretion, to H for H's education, support, and maintenance. The trustee also may pay income or corpus for G's medical expenses. H is the remainder beneficiary of the second trust and will receive the trust corpus upon G's death.
- (ii) Under these facts, there are significant non-tax differences between the substantive terms of the two trusts, so tax avoidance will not be presumed to be a principal purpose for the establishment or funding of the separate trusts. Accordingly, **in the absence of other facts or circumstances that would indicate that a principal purpose for creating the two separate trusts was income tax avoidance**, the two trusts will not be aggregated and treated as a single trust for Federal income tax purposes under this section.

# Non-Grantor Trust Structuring

Non-Grantor Trust  
Planning: SALTy SLATs



# Trusts Structuring Post Act

- Variations in planning may occur because of the SALT changes. The doubled estate tax exemption and the costlier SALT situation may drive practitioners to thread a new trust tax needle.
- Most trust planning, with one major exception, generally relied upon the creation of grantor trusts. The taxation of trust income to the grantor was an effective tool to burn or reduce the client/grantor's estate, facilitate further tax oriented planning (e.g. swaps of trust assets for personal cash to obtain a basis step up on highly appreciated trust assets), etc. For ultra-wealthy clients (wealthy relative to the new exemption amounts) that planning may continue.

# The Challenge of Creating Post-TCJA Non-Grantor Trusts

- Although by excluding the grantor and the grantor's spouse as beneficiaries means a non-grantor trust may readily be created, many taxpayers do not want to lose access to the property transferred to a trust as well as the income the property thereafter produces. This is particularly the case after the Act because of the large wealth transfer tax exemptions.

# Trusts Structuring- SALTy SLATs

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

# More on Adverse Parties

- If the remainder beneficiary of a trust must consent to a distribution to the grantor or spouse, the remainder beneficiary certainly seems to be adverse. Although Treas. Reg. 25.2514-3(b) deals with the meaning of adversity for general power of appointment purposes and not necessarily for purposes of Sections 676 and 677, it seems likely the remainder beneficiary should be deemed adverse for those sections as well and, therefore, the trust should not be deemed to be grantor trust, but will instead be treated as a separate taxpayer.

# Does Consent of Adverse Party = Gift?

- If the beneficiary having the adverse interest consents to distributions to the grantor or grantor's spouse, the beneficiary may be deemed to have made a gift, by reason of being considered to have transferred a part of his or her property interest in the trust.
- It seems relatively certain that a beneficiary entitled to income from a trust makes a gift by exercising a lifetime special power of appointment in favor of another.
- The IRS has ruled that a beneficiary makes a gift when giving up an interest in a trust even if the beneficiary is not entitled to any distribution or benefit from the trust, such as where the beneficiary is entitled only to distributions made by a trustee in the exercise of sole and absolute discretion and even if, apparently, someone (such as the current beneficiary to whom distributions are made with the consent of the remainder beneficiary) holds a special power of appointment to divert the trust assets away from the remainder beneficiary. However, as some of the private letter rulings indicate, the value of any such gift may be de minimis so that any such gift would be extremely small and possibly qualify for the gift tax annual exclusion under Section 2503(b).

# SALTy SLATs – Drafting Tips

- Start with a form for a BDT.
- Trust should intentionally omit the swap power and other powers that might make it grantor as to the settlor.
- Delete the Crummey power included to make the trust grantor as to the beneficiary.
- Add requirement for approval or provide veto to non-adverse party on distributions to spouse.
- It may be preferable to form in trust friendly jurisdiction if the goal is also to avoid state income tax on passive assets transferred to the trust beyond what is needed to pay property taxes.
- The SALTy-SLAT ( also called SLANT) approach, leads to a similar place as the modified ING discussed below.

# Non-Grantor Trust Structuring

Non-Grantor Trust  
Planning: INGs



# Trusts Structuring- Traditional ING's Post TCJA

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

# Trusts Structuring- The Completed Gift “ING”

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

# Completed Gift ING

- A gift is rendered incomplete where the grantor retains the power to modify and/or revoke the Trust unilaterally, or in conjunction with a non-adverse person. Thus, in the ING rulings, where incomplete-gift status was desired, the grantor had retained such powers.
- But if completed-gift status is sought, the grantor should not retain such powers.
- The ING trust should be located in a jurisdiction whose laws would prevent creditors from accessing trust assets. For if under state law the grantor's creditors can access the trust's assets, the gift is incomplete on the rationale that the grantor in effect retains a revocation power, i.e., the ability to relegate creditors to the trust's assets.
- Any of the approximately 18 jurisdictions permitting self-settled domestic asset protection trusts should qualify as appropriate situs for a completed-gift ING.

# Completed Gift ING

- Specifically, to make the transfers completed gifts, the grantor would not retain certain powers the grantors retained in the ING rulings—that is, the grantor would not retain any special power of appointment exercisable by Will (falling under the Section 674(b)(3) grantor trust exception) or any lifetime power (falling under the Section 674(b)(5) grantor trust exception), held in a non-fiduciary capacity, to distribute corpus pursuant to a health, education, maintenance or support (HEMS) standard, as the retention of any of these powers would render the gifts to the trusts incomplete. These powers also would have caused the trust to be included in the grantor’s gross estate under Sections 2036(a)(2) and 2038 but there should be no inclusion without them unless the trust is created in a jurisdiction where the grantor’s creditors could attach trust property, or the IRS can establish there was an understanding that distributions would be made to the grantor by the trustee. Moreover, if distributions may be made only to persons other than the grantor, there should be no finding of an understanding that the grantor would benefit from the trust even if the grantor’s spouse (as opposed to the grantor himself or herself) is a beneficiary and receives distributions.

# Completed Gift ING

- Hence, a taxpayer may create an ING type trust but, by not retaining certain powers included in the standard or traditional ING trust, render the transfers to this new variant of the ING trust as being completed for gift tax purposes. Although some might view that the estate tax benefits of completed gifts to a trust are eroded to the extent trust property is returned to the grantor or spouse, the high exemptions may make that unimportant for the vast majority of taxpayers. Also, in many if not most such planning scenarios, the intent will not be to make distributions to the spouse. Rather the objective will be to assure the client access to funds in the trust if necessary in order to give the client the confidence to make the transfer. In no situation should a client ever transfer too large a proportion of his or her assets to this or any other structures as such an excessive transfer might constitute a fraudulent conveyance. Thus, clients creating completed gift INGs should have sufficient resources outside the structure. In any case, the trust could acquire assets (such as residences or works of art) for the use by the grantor or spouse without, it seems, causing estate tax inclusion unless a finding is made that there was an understanding that the trustee would do so for the benefit of the grantor. It seems relatively certain that the rent-free use of property does not constitute a distribution of distributable net income (DNI) from the trust to the beneficiary which would cause such income of the trust to be shifted to the beneficiary under Section 662.

# Completed Gift ING

- To make the transfers completed gifts, the grantor would not retain certain powers the grantors retained in the ING rulings...
- The grantor would not retain any special power of appointment exercisable by Will (falling under the Section 674(b)(3) grantor trust exception).
- The grantor would not retain any lifetime power (falling under the Section 674(b)(5) grantor trust exception), held in a non-fiduciary capacity, to distribute corpus pursuant to a health, education, maintenance or support (HEMS) standard, as the retention of any of these powers would render the gifts to the trusts incomplete.
- These powers cause the trust to be included in the grantor's gross estate under Sections 2036(a)(2) and 2038 but there should be no inclusion without them unless the trust is created in a jurisdiction where the grantor's creditors could attach trust property, or the IRS can establish there was an understanding that distributions would be made to the grantor by the trustee.

# Completed Gift ING

- May create an ING type trust but, by not retaining certain powers included in the standard or traditional ING trust, render the transfers to this new variant of the ING trust as being completed for gift tax purposes.
- Although some might view that the estate tax benefits of completed gifts to a trust are eroded to the extent trust property is returned to the grantor or spouse, the high exemptions may make that unimportant for the vast majority of taxpayers.
- In many planning scenarios, the intent will not be to make distributions to the spouse. Rather the objective will be to assure the client access to funds in the trust if necessary in order to give the client the confidence to make the transfer. In no situation should a client ever transfer too large a proportion of his or her assets to this or any other structures as such an excessive transfer might constitute a fraudulent conveyance.

# Converting Grantor to Non-Grantor

# Converting Trust Status

- To convert an existing grantor trust into a non-grantor trust the grantor, and perhaps the grantor's spouse, would have to release all the powers in the instrument that would taint it as a grantor trust. If there are Crummey powers in the instrument, once grantor trust status is turned off, the grantor powers that had trumped the Crummey powers ability to make the trust partially grantor as to the Crummey power holders will become effective and must also be addressed.
- Can you convert/decant an existing grantor trust into a non-grantor trust? What about a non-grantor trust being converted to a grantor trust? Clearly with the changes in the law one characterization may have been preferable in the past, a different characterization may be more advantageous now, and if the individual tax changes sunset in 2026 a different characterization may be more important then.

# Converting Trust Status

- Practitioners should consider approaches to incorporate flexibility for this type of planning in trust instruments. For example, a power to swap assets and to lend without adequate consideration should be excluded if non-grantor trust status is desired. However, it might be advisable to consider empowering a named person to add these rights back into the trust if appropriate at a future date.
- Converting a non-grantor trust to a grantor trust should not have any adverse income tax consequence. PLR 200848017, CCA 200923024.
- If a non-grantor trust is converted to a grantor trust the non-grantor trust should file a final income tax return through the date of conversion. All income should pass to the new grantor trust. IRC Sec. 642(h).
- Converting from a grantor trust to a non-grantor trust may, however, trigger income tax costs, e.g. if there are liabilities in excess of basis.

# Home Sale Exclusion and Basis Loss Issues

# Loss of Home Sale Exclusion Possible

- A sale of the residence owned by a non-grantor trust would not qualify for the gain exclusion under Section 121 given that the trust, not the grantor, is treated as the owner.
- A decedent's estate and revocable trust may qualify for the home sale exclusion, that benefit does not extend to a non-grantor trust or to a trust beneficiary who has used the property as his or her principal residence.
- Toggle on grantor trust status in anticipation of the sale. This might be done by having Trust Protector or other designated power holder add the Grantor as a potential beneficiary, or give the Grantor certain powers over the Trust. Once that occurs, the grantor would again be treated as the owner, qualifying any gain for the exclusion after the expiration of two years.

# Loss of Basis Step up on Death Possible

- Basis of the residence after the death of the grantor.
- Likely that Section 2036(a)(1) would result in inclusion of the residence in the grantor's gross estate given the grantor's rent-free use of the residence after the creation of the trust. However, it is not clear that this would trigger an adjustment in basis under Section 1014.
- Possible solution - convert to a grantor trust before the grantor's death if the grantor repurchased the residence from the trust before death – which could be accomplished on a tax-free basis if the repurchase is made after the conversion to grantor-trust status.
- The IRS, if advancing a contention that the residence is included in the grantor's estate under Section 2036(a)(1) by reason of its use by the grantor while held in trust, might also contend that the use of income generated by trust assets that is used to pay for property taxes on a home used by the grantor causes those trust assets to be included in the grantor's gross estate as well.
- Another approach – sell house to non-grantor trust to lock in exclusion if gain less than the \$250,000/\$500,000.

# **Should Every Trust be a Non-Grantor Trust?**



# Non-Grantor Trusts are Not the Assured Answer for Many

- Certainly, every trust cannot and should not be structured, or restructured, to be a non-grantor trust. Planners will likely find that there will be a more diverse array of trusts in many client's plans. Given the enhanced benefits of using non-grantor trusts post-Act it is no surprise that many articles and webinars focused on the new benefits of using non-grantor trusts. The purpose of the following discussion is to provide a broader and more balanced view of the decision process as to whether a grantor or non-grantor trust should be used.
- If the individual income tax changes sunset in 2026 and could be modified by future legislation is the cost and hassle of complex planning worthwhile?
- How effective will state efforts be to circumvent SALT limitations? Does this obviate the need to plan or should planning be pursued as it may provide tax savings with greater certainty?
- Will the client accept the steps necessary to make a trust a non-grantor trust? For SALTy-SLATs is the client comfortable having a child/beneficiary as an adverse party approve distributions?

# Non-Grantor Trusts are Not the Assured Answer for Many

- Will a child remainder beneficiary suffice to constitute an “adverse party” for these purposes to assure non-grantor status? The Regulations require that the adverse party have a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power. There is, unfortunately, little clarity on the delineation of what is “substantial.” Thus, there may be more risk into the use of the adverse party mechanism to preserve or achieve non-grantor trust status than many realize. Is instead of using this technique giving a person in a non-fiduciary capacity a special or limited power to appoint to the spouse a better option? That technique might also be subject to a potential challenge based on an implied agreement between the power holder and settlor (or spouse).
- Is an ING model a safer approach to addressing the need for an adverse party as contrasted with the non-grantor SLAT approach? Will the complexity of making it a completed gift outweigh the advantages? Will the ING characteristic of a Distribution committee (see below) add too much cost, complexity or administrative burden?

# Non-Grantor Trusts are Not the Assured Answer for Many

- If life insurance is involved with the non-grantor trust raise transfer for value issues? Can the use of income be to pay premiums on life insurance on the grantor's life be drafted around to avoid tainting the trust as a grantor trust? Perhaps grantor-SLATs/MILITs or traditional ILITs should remain.
- If the trust owns S corporation stock conversion from a grantor trust to a non-grantor trust will require conforming to the qualified Subchapter S trust ("QSST") or electing small business trust ("ESBT") requirements.
- Another issue might arise on conversion. Could it create a claim by a beneficiary against the trustee now that the trust or beneficiaries, not the grantor, have to bear the income tax burden?
- It may not be sufficient to craft the trust instrument as a non-grantor trust, or to convert a grantor to non-grantor trust properly. The trust must also be administered in a manner that conforms to the non-grantor trust requirements. For example, if the trustee unbeknownst to the practitioner purchases life insurance on the grantor's life, and pays a premium, that might characterize the trust in whole or part as a grantor trust.

# Non-Grantor Trusts are Not the Assured Answer for Many

- Should loans be prohibited? Even if prohibited by the instrument the trustee's authorized action of making a loan might undermine the intended non-grantor status. If the instrument prohibits distributions to the settlor's spouse without the consent of an adverse party, what if the trustee makes a distribution without such consent?
- What if the trustee or a protector acts in a manner that suggests and implied agreement to benefit the grantor thereby undermining non-grantor status? *SEC v. Wyly*, 56 F. Supp. 3d 394 (SDNY, 2014).
- Perhaps new types of savings language should be added to non-grantor trust instruments? In all events, as the complexity and variety of trusts in a client's plan expand the importance of annual reviews with counsel and the rest of the planning team becomes more essential. It will be more difficult for clients, and even some of the client's non-tax advisers, to differentiate grantor from non-grantor trusts, and to use the appropriate trust administration techniques for the right trust.
- The multiple trust rules should be considered although they do not appear to be an issue. Nonetheless, trusts can and should be differentiated.

# Non-Grantor Trusts Not Always Better

- While a major premise of this presentation is that in many instances non-grantor trusts, applied differently than traditional trust planning, will provide significant benefits, that excitement should be tempered by the reality that in many instances more typical and traditional grantor trust planning remains preferable.
- Grantor trust remains valuable for taxable estates, e.g. ultra-high net worth clients.
- Grantor trusts may have modest cost to moderate wealth clients in low tax states.
- For taxpayers holding certain types of assets (e.g., life insurance and active business interests whose income would be taxed in the high tax state regardless of whether transferred to a non-grantor trust), use of grantor trusts may remain preferable.

# Home Ownership in SALT Planning

# How Many Trusts; Tenants in Common

- Example: Real estate taxes on the residence are \$50,000 a year, the taxpayer could create five non-grantor trusts (e.g., one each for the taxpayer's three children and two grandchildren ) and transfer 20% of the property to each together with sufficient assets to produce for each trust at least \$10,000 of taxable income which should be offset by the \$10,000 real estate tax deduction.
- **Tenants in Common** -This could be accomplished by transferring undivided interests in the real estate to the trusts as tenants in common.

# LLC Home Ownership

- The real estate could be transferred to a limited liability company (LLC) which would be taxed as a partnership under Treas. Reg. 301.7701-3, and membership interests in the LLC would be transferred to the appropriate number of non-grantor trusts.
- Only one check would need to be sent in to pay the real estate taxes (or other costs of owning and administering the property).
- A partnership (such as an LLC taxed as one) can opt not to file a separate partnership income tax return and have the tax attributes attributed directly on the partners returns (in this case, the non-grantor trusts that are the partners). IRC Sec. 761.

# Election Out of Partnership Tax Status - Requirements

- The entity must be used for investment purposes only and not for the active conduct of a business.
- With the consent of all of its partners.
- Elect to be excluded from Subchapter K (partnership tax rules) even though it is otherwise a partnership.
- The election out must not be made no later than the time for filing the tax return for the partnership for the first tax year the exclusion is desired.
- An organization formed for the joint use of property, or certain security dealers, may also elect out. Thus, a group of persons joined for the joint purchase, retention, sale or exchange of investment property may elect out.
- The partners (or members in the case of an LLC taxed as a partnership) must be able to individually calculate their income without the need to compute partnership taxable income.
- The partners must own the partnership property as co-owners. This is likely an issue governed by state law and it may suggest that it is best to have a contractual arrangement confirming this.

# Election Out of Partnership Tax Status - Requirements

- The partners must reserve the right to separately take or dispose of their shares of any property acquired or retained. If the parties do not reserve the right to separately take their shares of the property, the election out is not valid. This latter requirement should be addressed in the governing instrument for the LLC opting out.
- The partners cannot irrevocably authorize a person acting in a representative capacity to purchase, sell, or exchange such investment property. However, each partner may delegate the authority to purchase, sell, or exchange his or her share of any such investment property for his account, but not for longer than one year.
- The partnership income tax return, Form 1065, on which the election out is made must include certain information as required by the regulations: The members' names, addresses and tax identification numbers, the location of the partnership, a statement that the organization qualifies for making the election to be excluded from Subchapter K, and that all of the members elect out..

# Use of Home Held in Trust

# Use of Home held in Trust

- Each co-tenant should be entitled to the use of commonly owned property. If the trusts own the property as co-tenants (either directly or through the LLC as mere nominee for them ), each trust could allow its beneficiaries to use the property and, as indicated above, no income should be imputed to either the trust or its beneficiaries. In fact, no trust presumably will have any DNI as it will have no taxable income.
- If it is desired that the taxpayer or the taxpayer's spouse be able to continue to occupy the property, either the grantor (or spouse) could continue to hold some interest as property as a co-tenant or be a beneficiary of one of the trusts that is a co-owner.
- To avoid grantor trust status where the either the grantor or the spouse is a beneficiary, distributions must be made to either only with the consent of an adverse party.
- If the grantor and spouse do not retain any equity interest in the residence, and the trust requires an adverse party to approve a distribution to the spouse who is a beneficiary, it might be advisable to have the adverse party corroborate his or her consent to the use of the residence in writing.

# Mortgage Issues

# Mortgages may Effect Planning

- If home is subject to indebtedness the transfer may accelerate the debt. Hence, it usually is necessary to obtain the consent of the debt holder to the transfer (that is, so the payment of the debt will not be accelerated).
- Consider the restrictions TCJA has placed on mortgage interest deductions, if a taxpayer has a grandfathered pre-Act mortgage he or she will likely not wish to jeopardize that.
- If the grantor is personally liable on the debt and the debt essentially offsets the grantor's liability, the trust that holds the property may well be a grantor trust. Therefore, it will be important to structure the transfer so the grantor cannot be benefitted by the trust satisfying debt for which the grantor is personally liable.

# Qualified Personal Residence Trusts (QPRTs)

# Old QPRT Illustration

- **Example:** Client age 50 in 2002, when the estate tax exemption was \$2 million, transferred her personal residence valued at \$2 million, which alone would have her at the threshold of triggering an estate tax based on the law then in existence, to a QPRT. The QPRT was to last 20 years until 2022. The taxable gift on funding would have been about \$540,000. Assuming the 50% estate tax rate then in existence, and a 4% growth in value of the house, the house would be estimated to be worth about \$4.4 million in 2022 and the estate tax savings realized about \$1.9 million. Under current law the estate tax savings would be zero but the appreciation in the home would be well beyond the IRC Sec. 121 home sale exclusion and none of it would qualify for an income tax basis step up because it was in the QPRT. Now, what might have been a useful plan, is a tax negative. This is an issue that will concern many clients with old QPRTs.

# Issues to Consider on Old QPRTs

- If the house were merely deeded out of the QPRT, when will the elderly parent die? What will be the value of his estate? What will the federal estate tax exemption be? What will be the status of any state estate tax at that time?
- The federal estate tax exemption is reduced by half after 2025. It is possible that a different administration elected in 2020 or 2024 may change the estate tax rules and make them even less favorable. How can that risk be assessed? As the grantor/parent ages, it may prove impossible to plan in the future should that occur.
- What if the exemption is reduced after the 2020 election to \$3.5 million, what can be done then? Re-plan? What if the elderly parent is incapacitated and cannot plan at that time?
- Practitioners engaging in unwinding old QPRT plans should be certain to caution clients about the many tax risks that might entail.

# Issues to Consider on Old QPRTs

- What about the legalities of the transfer of the deed in our example? Does the trustee of the QPRT have the authority to merely deed the house back to the trust? Without fair consideration for the transfer of the house that is not likely. The trustee has a fiduciary duty to the beneficiaries of the QPRT, and to adhere to the terms of the trust. Deeding a valuable house back to the settlor without commensurate consideration could expose the trustee to liability. What if the beneficiaries under the QPRT are different than the beneficiaries under the settlor's will? What if the settlor remarries a new spouse?
- If the trustee had no authority to transfer the house will the settlor/parent be able to transfer good title to the house if he ever sells the house in the future? If the trustee did not have legal authority to transfer the house will a future buyer of the property require sign offs by the trustee of the QPRT and beneficiaries of the QPRT in order to get good title to the property?

# Issues to Consider on Old QPRTs

- What if the taxpayer affirmatively structured the transaction to run afoul of the estate inclusion issues on bad QPRT cases? If the taxpayer signs a lease to rent the house from the QPRT for \$1/year for life that would appear to cause estate inclusion without the issues suggested above. Such a lease would appear to constitute a retained enjoyment to the property for life causing estate inclusion. IRC Sec. 2036(a).
- The IRS has ruled that so long as the property will be leased at fair market value rental, the taxpayer has not retained any economic benefit from the property and, thus, Code Sec. 2036(a) does not apply.
- This conclusion assumes that there is no implied agreement or understanding that the parties can remain in the residence even if they do not pay the rent (IRS Letter Rulings 9714025 and 9829002).
- A lease permitting the settlor to rent the house after the expiration of the QPRT term by paying fair rent should not affect the status of the QPRT. PLRs 9425028, 199916030, and 199918042.

# Issues to Consider on Old QPRTs

- While the retention of a life estate in the house should cause estate inclusion, there are potential issues to consider. In one case, the settlor's failure to pay fair rent from the termination of a QPRT until death did not cause the value of the residence to be includible in gross estate. *S. Riese Est.*, TC Memo. 2011-60). So exactly how much personal use is required to cause estate inclusion?

# **Vacation Home Planning Post JCTA**

# Vacation Homes and Itemized Deduction Limitations -1

- How a vacation home is characterized may have different tax consequences after the Act and some taxpayers may choose to change the characterization of vacation properties as a result.
- A vacation home used solely for personal purposes is treated as a residence. But the restriction, if not loss, of property tax deductions and the loss of home mortgage interest deductions might have taxpayers who intentionally opted not to rent their vacation homes instead pursue that option. Under pre-Act law some taxpayers may have been satisfied with the economic cost of carrying a vacation home based on the tax benefit of their deducting mortgage interest and property taxes on the property. The curtailment of those benefits might mean a need to consider supplementation with rental income, or converting the vacation home to a rental to secure deductions as well as rental income.

# Vacation Homes and Itemized Deduction Limitations - 2

- If the vacation home is rented for less than 15 days during the tax year, the income from such a limited rental is not taxable and no deductions are allowable with respect to the rental period. IRC Sec. 280A(g).
- A vacation home is characterized as a personal residence if personal use exceeds the greater of: 14 days; or 10% of the days the home is rented. IRC Sec. 280(A)(d)(1)). For example, if the vacation home is rented 200 days then the taxpayer's personal use can be 20 days, not 14. If personal use is less than both tests then the vacation home is considered to be held as an investment property, although expenses still will still have to be allocated as between personal and business use.
- If the vacation home is rented then mortgage interest paid is subject to interest allocation rules and a portion may be deductible as relating to the rental that may no longer be deductible as relating to the personal use. Reg. §1.163-8T.

# Should You Convert to Rental?

- The TCJA will spur many taxpayers to convert vacation or second homes to business or rental income producing property. The motivation for conversion may be that the economic costs of carrying the property post TCJA have simply increased sufficiently so that the taxpayer requires the rental income to offset that higher net of tax carrying cost. In other instances, taxpayers might simply wish to salvage some of the tax advantages that they enjoyed prior to TCJA. That result may be achievable for some, but that will require addressing a range of complex vacation home tax rules.
- To avoid the mortgage interest and property tax deduction limitations of TCJA, vacation residences with mortgages can be converted to income producing properties. Then the interest limitation and the property tax limitation will no longer apply, as they become deductible as a rental expense.

# Should You Convert to Rental?

- If the rental arrangement is profitable and can be considered to be a trade or business under new IRC Sec. 199A then it may qualify for the 20%-percent deduction from the net income.
- If the rental arrangement is not profitable the loss limitation rules of Code Sec. 280A discussed below might restriction deductions. Even if the taxpayer can plan around those limitations the passive loss rules of Code Sec. 469 may limit the losses that can be taken currently. The web of loss limitation rules have not been stricken from the Code by TCJA.

# **Conclusion and Additional Information**

# Conclusion

- Planning to use non-grantor trusts to own a residence may facilitate salvaging property tax deductions.
- In many instances combining this planning with 199A planning, charitable deduction planning and saving state income taxes may make the planning more viable.
- A myriad of house tax issues have been created by TCJA.

# Additional information

- Contact Martin M. Shenkman via email at [shenkman@shenkmanlaw.com](mailto:shenkman@shenkmanlaw.com)



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