Creative Planning Tips

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Gather a potpourri of practical planning ideas for clients of all wealth strata, practical practice pointers and more for estate planning practitioners. Topics will range from technical planning tips (e.g. the use of a two tier Wandry clause to mitigate against a potential Powell issue), to tips on planning before the 2020 election for most clients, and practical ideas to safeguard aging clients and increase the role and services of practitioners. Receive pointers to minimize malpractice risks, and more. The content will be updated to reflect new developments occurring up to the program date.

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Practice Safer Estate Planning

Malpractice risks and issues are significant. Safer practice is worth considering by all advisers, including not just attorneys and CPAs, but banks, trust companies, wealth advisers and more. Despite (or perhaps especially because of) such significant pressure for billable hours and revenue generation (whether as hours billed, assets under management or otherwise) every one of the allied professions should reassess its practice methods and in particular disclaimers. Consider some of the following possible steps based on recent cases.[1]

Consider adding cautionary language to cover letters.

Sample Clause: "*Estate planning is inherently complex, subject to varying interpretations, and the laws change frequently. Ongoing review and maintenance of every plan and document is essential. There is no assurance that any particular result will be realized. There are risks and negative consequences to every planning step and technique, all of which have not been enumerated in this letter or other communications. By proceeding with this planning, you accept these risks*."

Consider adding cautionary language to retainer agreements or footers on bills, or both.

Sample Clauses:

*"**Risks; No Guarantees**: You understand and acknowledge: Results of any plan are never guaranteed. Many aspects of many, if not most, estate and related plans are not only uncertain, but subject to a wide spectrum of different views by other advisers, the courts, the IRS, and other authorities. Most strategies have negative consequences (e.g. save estate tax, lose basis step-up). Even many common strategies, techniques and transactions are subject to tax, legal, financial, and other risks and uncertainties. While we endeavor to identify some of the risks of a plan, all risks and issues with each component of a plan are not possible to identify or communicate. Creating a collaborative team will help identify more issues with your plan. Further, the fact that we communicate verbally or in writing certain risks should never be interpreted as an indication that any such listing or communication is a comprehensive listing or communication of every risk involved. The risks of any transaction can be further compounded by improper administration of the plan, failure to meet annually to review and update the plan, changes in the tax and other laws that may reduce hoped for benefits or even result in more costly results then had no planning been pursued.*

***Tax Audits**: To the extent that you engage us, or engaged us in the past, to perform tax, estate, asset protection and other planning, which may include, or may have included, estate, gift, wealth preservation and/or wealth transfer planning and other services, we may have suggested*

[1] Based on the article: Shenkman, Glazier and Zaritsky, "Raia v. Lowenstein Sandler LLP - Thoughts on a Recent Malpractice Case LISI Estate Planning Newsletter #2724 (May 16, 2019).

a number of strategies, and may have assisted in implementing strategies, that the IRS or state tax authorities, or others, could challenge. Possible challenges could be asserted even though we communicated several of the risks associated with such strategies. Possible challenges could be asserted also for risks that were not discussed, including challenges by the government that could cause inclusion of assets previously transferred out of your estate in your estate. Assets that had been transferred out of the estate as part of the recommended strategies will most likely not be adjusted to their date of death value, which could result in a capital gains tax liability, possibly a depreciation recapture tax liability, and/or a negative capital account recapture liability. You agree that we shall not be liable, to any extent, for any assessments of tax, interest, or penalties resulting from recommended strategies or previously implemented strategies."

Consider adding cautionary language as a preamble to estate planning and other memorandum.

Sample Clauses:

*"**Disclaimer Statements and Risks***

***Limitation to Client**: This Planning Memorandum is solely for the benefit of the client named above and is not to be relied upon by anyone else without the written consent of Shenkman Law. We assume no responsibility for income tax, gift tax or estate tax, or any other consequences, to any other persons. Such persons should consult and rely upon their own counsel, accountant, tax advisor or other advisors. Except for the information expressly stated herein (and **no statements herein are to be construed as legal opinions**), no other suggestions, information or analysis is implied, and no other suggestions, information or analysis should be inferred. Any strategies suggested are intended solely for the use of the client named above, and cannot be relied upon by others. If you want a formal legal opinion on which to rely you have to separately engage us to render such an opinion if it is feasible. Bear in mind that significant additional cost will be incurred regardless of whether or not a favorable opinion can be reached if you request one. If you are not clear on the distinction and import of the discussion in the memorandum following and a formal legal opinion please call to discuss this. The following memorandum presents discussions of options and certain issues, **not** conclusions of law. The following memorandum outlining options may weigh various considerations and/or options, often when there is no single correct answer and the outcome is not fully predictable to any degree of certainty.*

***Matters in Purview of other Advisers**: Although we may address certain income tax consequences, those matters are within the purview of your CPA and should be addressed as such. Although we may address certain insurance matters or investment matters, those matters are within the purview of your insurance and/or investment adviser, and should be addressed as such. Although we may address certain real estate or corporate (entity) matters, those matters are within the purview of your general counsel (or your specific real estate or corporate counsel) and should be addressed as such.*

***Information Will Not Suffice to Avoid Tax Penalties or Interest Charges**: The information in this memorandum, in any attachment, or cover letter (including previous and subsequent correspondence during this engagement) are not intended or written to be used, and it cannot be used to: i) avoiding any penalties imposed by the IRS or any state tax authority; ii) to promote,*

market or recommend to any other party any tax-related matter such as an investment, product, service, advice or position.

***Scope Limitations**: The scope of this Planning Memorandum is expressly limited to the strategies or matters discussed herein. No other issues are considered and Shenkman Law assumes no responsibility beyond the issues to which this Planning Memorandum is devoted. Additionally, no analysis is provided on any of the following issues: (1) any impact of future legislation or other changes in the law, whether retroactive in nature or not; (2) any issues specifically excluded; (3) non-US taxes, or taxes in jurisdictions not specifically mentioned; and (4) any taxes not specifically mentioned; (4) life insurance or other insurance selection; (5) recommendations of investment products, securities or strategies; (6) Medicaid, elder law, supplemental needs or special needs planning; (7) qualified plan issues; (8) annuities; (9) valuation reports or issues; (10) any other matter excluded in the Billing Arrangement documents or other communications.*

***Law Changes**: The suggestions and discussions in this Planning Memorandum are based upon the applicable federal, state and local tax and other laws as of the date of this Planning Memorandum. Such authority may change in the future, and such change may be applied retroactively. A change in state law may impact income, estate or other tax consequences. Shenkman Law assumes no responsibility to update this memorandum, or notify you in any manner, if the applicable law changes. Federal and state taxing authorities, regulatory agencies, the IRS, and the courts are not bound by the analysis herein and may take very different views or interpretations of the law, the facts or both. The analysis contained herein supersedes all prior oral and written discussions, if any, pertaining to the issues involved. But it may be modified by subsequent communications. We may have suggested a number of strategies the IRS or state tax authorities, other governmental agencies, regulatory bodies or courts may challenge. While we have discussed a number of associated risks with you, possible challenges could be asserted which were or were not discussed or even contemplated. We are not responsible or liable, to any extent, for any gift tax, income tax or estate deficiencies or assessments, interest, or penalties that may arise, or the results of any court holding including the piercing or disregarding of entities, trusts or transactions. There may now be proposed Federal, state tax or other legislation which, if enacted, could modify or eliminate the benefits of many strategies if not grandfathered. The IRS, state tax authorities, plaintiff's counsel, and others have, and may continue to, attack various strategies and techniques that may be suggested in this Planning Memorandum.*

***Your Responsibilities**: We have relied upon your assertion that the information provided, facts and assumptions provided are true, correct, and complete. However, we have not independently audited or otherwise verified any of the information, facts or assumptions, though we may have asked for clarification, done internet or other searches or consulted with your other advisers. A misstatement or omission of any fact or a change or amendment in any of the assumptions we have relied upon may require a modification of all or a part of the discussions or suggestions contained in the Planning Memorandum. In addition, our suggestions and discussions are based on the facts and assumptions as asserted to us by you and are at best only current as of the date of this Planning Memorandum. We have no responsibility to update this Planning Memorandum, or otherwise notify you, for events, circumstances or changes in any of the facts or assumptions occurring after the date of this Planning Memorandum or the date of any communication to you. It is the responsibility of the client to engage Shenkman Law or another adviser to revisit these matters*

from time to time, especially if our general communications or general media coverage suggests a change in the law, planning approaches or perspectives that might affect you, your planning or the discussions or suggestions in this Planning Memorandum. It is your responsibility to consider all communications we disseminate as well as general media coverage of events and contact us should any perhaps apply to you, your planning or this Planning Memorandum.

Options; Your Decision*: Although we aid you in the decision-making process, suggest alternative recommendations verbally or in writing to help you achieve your objectives, and assist you in determining how well each alternative meets your estate planning objectives, the responsibility for estate planning decisions is solely yours. These services are not designed, and should not be relied upon, as a substitute for your own judgment, nor are they meant to mitigate the necessity of ongoing review. These services are designed to supplement your own planning and analysis and aid you in achieving your objectives*."

Use Consent Dividends to Avoid PHC Tax

With the rush to C corporation status in light of the low 21% federal corporate tax rate, the personal holding company ("PHC") tax could be a significant concern for some C corporations. Until limited liability companies ("LLCs") became ubiquitous in planning, the use of S corporations was common in the context of family transactions. S corporations, unlike C corporations, permit the flow through of income to the shareholders. However, they are subject to a number of stringent restrictions which often constrained estate planning, e.g. only specified trusts may hold S corporation stock, there can only be a single class of stock (although voting and non-voting shares are permitted), etc. While C corporations may have become more popular because of the new favorable tax break, that is unlikely to reduce significantly the number of S corporations involved in family estate and other plans. But practitioners need to be alert for the unique tax considerations that C corporations might require.

The PHC tax, imposed under Section 541, was enacted decades ago, at a time when the marginal corporate tax rate was well below the individual top income tax rate. The purpose was to prevent taxpayers from accumulating income inside a C corporation at a lower tax rate. The PHC tax had remained largely irrelevant for many years because corporate tax rates exceeded the top individual tax rates. The 2017 Tax Cuts and Jobs Act (the "Act") reversed the relationship of corporate and individual tax rates with the well publicized 21% corporate tax rate which is lower than the marginal individual rate. As a result, the PHC tax again became relevant. As a result of the new relationship between the maximum individual rate at 37% (or 40.8% if the 3.8% NIIT is applicable) and the maximum corporate of 21% there is now a significant incentive to hold cash and investment assets inside a C corporation rather than distribute them. Many taxpayers have modified existing entities into C corporations or have created new C corporations instead of other forms of entities. One risk of using C corporations in this manner is the exposure to the PHC tax. But in addition, estate planners should consider the implications of the restructure of another entity into a C corporation, buy-sell agreements, terms of trusts, succession planning and other "ripple effects" that might occur.

The tax is assessed under IRC Sec. 541, which provides: "541 - Imposition of personal holding company tax -In addition to other taxes imposed by this chapter, there is hereby imposed for

each taxable year on the undistributed personal holding company income (as defined in IRC Sec. 545) of every personal holding company (as defined in IRC Sec. 542) a personal holding company tax equal to 20 percent of the undistributed personal holding company income."

The aggregate of the 20% PHC rate and the regular corporate rate of 21% is 41% (and higher if the second tax on distributions to shareholders on dividends from the C corporation are factored into the analysis).

Personal holding company income ("PHCI") is determined by taking specified deductions from the C corporation's income. PHCI may include the following (but there are a host of exception and special rules): dividends, rents, mineral, oil and gas royalties, amounts received from contracts for personal services, income reported by a corporate beneficiary of an estate or trust, etc.

A personal holding company must meet an income and ownership test. The income test requires that PHCI comprises 60% or more of its adjusted ordinary gross income for the year. The ownership test requires that for the last half of the tax year more than 50% of the stock is owned directly or indirectly by five or fewer individuals. Constructive ownership rules apply. IRC Sec. 544. These will attribute to a particular shareholder shares in the C corporation that are owned by controlled entities, etc. This will likely aggregate shares transferred to various types of trusts used in estate planning.

If the C corporation passes the income and ownership test it could be subject to an additional 20% tax. So, planning can be done to avoid or fail the ownership or income test. For example, a C corporation could buy a business that produces significant gross income to enable the post-sale corporation to fail the 60% of income test. But what if a C corporation meets both tests? Can something be done to avoid paying the additional 20% PHC tax? Yes, the corporation may be able to pay a dividend to its shareholders to avoid the penalty tax. More specifically, the PHC can pay what is known as a "deficiency dividend" and avoid the PHC tax. See IRC Sec. 547.

The election is made by filing with the Form 1120 "U.S. Corporation Income Tax Return:"

- Schedule PH.
- Form 972 – "Consent of Shareholder to Include Specific Amount in Gross Income".
- Form 973 – "Corporation Claim for Deduction for Consent Dividends."

This recent ruling pertained to this process. In Private Letter Ruling 201901002, the IRS granted a C corporation an extension on the period of time during which it could make the election to pay a consent dividend and avoid the PHC tax.

The IRS granted the C corporation a 60-day extension to make the election for a consent dividend under Code Section 565 (which permit the corporation a deduction for such dividends). The rationale for the leniency was that the corporation made reasonably good faith reliance on its accountant who had not properly advised it. The accountant had evaluated the corporation's PHC tax at the consolidated return level and concluded that PHC tax did not apply. The accountant also failed to advise the taxpayer that it was necessary to make the consent dividend election.

Reconsider Existing and Future Trust Planning in Light of the Broader Implications of Kaestner

The Kaestner case[2] has been discussed extensively in the professional literature. Rather than evaluating the case or reciting the facts, the following discussion is a listing of planning implications, considerations and possible steps practitioners and trust officers might consider:

- The Kaestner case notes: "First, the beneficiaries did not receive any income from the Trust during the years in question. Second, they had no right to demand Trust income or otherwise control, possess, or enjoy the Trust assets in the tax years at issue. Third, they also could not count on necessarily receiving any specific amount of income from the Trust in the future." Does this suggest that any trusts that might have a 5/5 power, HEMS standard, or other provisions that might give the beneficiary any rights to demand trust income or otherwise a right to control, possess or enjoy trust assets, or a trust that terminates at a specified age, should be decanted now to remove those potential tax strings? Would a HEMS standard with an independent trustee be deemed control in the beneficiary merely because there is a definite standard for distribution? Perhaps. Note that in the Kaestner case the trust was decanted from the original trust that terminated at a specified age. Consider whether effectuating a non-judicial modification to curtail beneficiary control might taint the result as evidencing beneficiary control (in contrast to a decanting effectuated by the trustee).
- Practitioners and trustees might consider reviewing the possible benefits of converting a grantor trust to a non-grantor trust to save state income taxes. Caution is important. What if the Bernie Sanders-type estate tax proposal of including grantor trusts in the grantor's estate is eventually enacted?[3] It might be wise to retain a grandfathered grantor trust (if that is feasible). Consider installment sales, negative basis, income tax consequences of conversion. Evaluate whether grantor trust status versus possible state income tax savings is preferable.
- The trustee chose not to distribute any of the income to the beneficiary in the taxing jurisdiction. What might this mean if a person in a non-fiduciary capacity directed the trustee to make a distribution to a named person? Then the decision would not be in the trustee's discretion. Perhaps the recipient might not be deemed a "beneficiary" in a traditional sense. Might this change the analysis? For example, the taxpayer's parent creates a trust for the taxpayer's descendants. The taxpayer is not named a beneficiary of the trust. However, the trust states that the taxpayer's college roommate shall have a power, held in a non-fiduciary capacity, to direct the trustee to make a distribution to the taxpayer. Under the Kaestner analysis the taxpayer would have no authority to influence the trust, but it would not be the trustee choosing to make a distribution? How might this be treated?
- Whether the trustee has exclusive control over the allocation and timing of trust distributions was important in Kaestner. How will trusts with anything less than total

[2] On June 21, 2019, the Supreme Court of the United States published its decision in North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust, 588 U. S. ____ (2019) (Kaestner). This listing is based on an article on the case schedule to appear in Estate Planning magazine.

[3] "For the 99.8 Percent Act," S. 309 116th Cong. (2019).

trustee discretion be treated? Might decanting to a trust with a different distribution standard assure that beneficiaries have no control and cannot benefit from trust income?

- The trust is subject to governing law of a different jurisdiction then the taxing jurisdiction. The Trust in Kaestner was subject to New York law, not North Carolina law. Decanting might cure this defect if a particular trust was formed under the laws of a taxing state.
- The residence of individual trustees is a crucial factor. In the Kaestner case, no trustee lived in North Carolina. How will this apply in terms of an institutional trustee? Perhaps this suggests the benefit of using an institutional general trustee based in a tax friendly jurisdiction in lieu of a friend or family trustee in the taxing jurisdiction. That is an important planning step that too often is not used as those creating trusts tend to often name family members as trustees. The drawback of that is family members named may live in a taxing state. It may prove much less costly to name an institutional trustee in a no tax state and pay their annual fee. What does this criteria mean in terms of other trust positions?
- The Kaestner Court did not address other common positions in a modern trust. What of a trust protector? Trust investment director? Various power holders? All of these positions, if the individuals named reside in a taxing state, might taint the trust as subject to that state's tax system? So, consider where the person you name as a trust protector resides. Perhaps a trust protector should act in a non-fiduciary capacity and/or reside in a state without a state income tax. Another option might be for the trust to name an entity, e.g. a limited liability company ("LLC") formed in a tax friendly state (presumably the same tax friendly state where the trust is based) as trust protector (or investment advisor, etc.) and have the individual desired provide services as a manager of that LLC. Will that suffice to prevent a high tax state from taxing the trust?
- The physical location of trust records. In the Kaestner case, the trustee kept the trust documents and records in New York, not in North Carolina. Where are your trust records kept? In a modern digital age how relevant will this be when most if not all records might consist of cloud based digital records? Will moving all records to the cloud solve the issue?
- Trust asset custodians were located in a state other than the taxing state. Is it relevant where a large institutional investment advisor is located as to the state taxation? Yet this seems to be a factor noted by the Court. Is this now a consideration to inquire of an investment advisor when trustees are interviewing to outsource investment management?
- No physical presence in the taxing state. The trust should not rent or own an office in the taxing state. If these taints exist are alternative arrangements viable?
- The trust should not have any direct investments in the taxing state. Might this suggest that any, even insignificant, investment in the taxing state might taint the entire trust? Might those administering trusts be advised to divide the trust with one component trust holding any investments in the state, and all other investments being bifurcated in a separate trust? Some states take the position that any active business in their state will taint the entire income of the trust as taxable. If that situation affects a trust try to divide the trust. Many trust documents permit the trustee to divide the trust for a variety of reasons. If not, state law might permit division. If that isn't the case, decanting may provide another possible way to cure this state tax issue.

- The number of meetings between the trustee and beneficiary may be relevant. The Court noted: "the trustee's contacts with Kaestner were "infrequent." " It is not clear what the import of this factor mentioned by the court is to the analysis. Might the Court be suggesting that the more meetings the more influence the beneficiary might be viewed as having over access to trust income? That would not seem appropriate as it is the terms of the trust and the powers not given to the beneficiary, not the number of meetings, that would seem to be the relevant factor. But in the Kaestner case, even if there were more (many more?) meetings then two, that would not affect the terms of the trust which in the instant case gave the trustee sole discretion as to distributions. But the language in Kaestner suggests that the beneficiary's right to control is relevant. "the extent of the in-state beneficiary's right to control, possess, enjoy, or receive trust assets." Is this a suggestion that a large number of meetings might suggest a beneficiary's right to control? This seems unlikely. But, what if there was an implied agreement found between the beneficiary and trustee suggesting that the beneficiary may have "control"?
- The trust should not own real property in the taxing jurisdiction. What if the real property is held in an entity, such as a limited liability company or other disregarded entity, that would characterize the property as an intangible asset not real estate. Would that suffice to avoid the state taxation of the trust? Alternatively, as with a business activity in the state, consider segregating real property in a taxing state into a separate trust.
- Geographic location of trustee/beneficiary meetings was noted in Kaestner. What does this mean in an electronic age when web meetings are so common?
- The Kaestner Court noted that the trust did not terminate at a specified age distributing corpus to the beneficiary in the state in question. If it does, consider decanting the trust, which is what the Kaestner family did. If the trust distributes at age 25 all assets to the beneficiary, would that suffice to permit the state to tax the trust? What if the beneficiary is 1 year old and the trust distributed at age 75? Would that suffice for tax nexus? Although this is all unclear the more modern way to draft many trusts as long term or even perpetual is certainly a safer option.
- What if the trust instrument permitted the trustee to loan funds to the beneficiary? Would a loan taint the beneficiary as taxable on trust income? What if it was not the trustee but another person, perhaps in a non-fiduciary capacity, that directed that a loan be made to the beneficiary? Would that taint the trust accumulated income as taxable?
- What if the trust owns personal use property, such as a home, and permits the beneficiary to use it? If the property is located in the taxing state that might suffice as sufficient nexus to tax undistributed income under the Kaestner Court's discussions. But if the property were located in a different state would the use of property permit a different state to argue that the beneficiary resident in its state received benefit from the trust even though no income was distributed?

Aging and Longevity

Factor Life Expectancy of Wealthy Clients into Financial and Estate Planning Decisions

"*Men in the top one-fifth of America by income born in 1960 can on average expect to reach almost 89, seven years more than their equally wealthy brethren born in 1930. (Life expectancy for men in the bottom wealth quintile remained roughly stable at 76.*)" [4]

Consider what the above longevity statistics mean to planning. Using table life expectancies will understate actual life expectancy for the wealthy clients almost all advisers serve. Also, in the discussion of societal goals and the estate tax, the shocking statistics of expanding life expectancy for the wealthy and stagnant life expectancy for the lower tiers of wealth may well serve as an incentive for the proposals of universal health care to be paid for by a harsh estate tax. If the difference in life expectancies becomes more widely known it may only serve to fuel the desires of many Americans to address wealth disparity through tax law changes, etc. What might this mean to future tax and other legislation? What proactive steps might wealthy clients take now? Is this yet a further reason wealthy clients should plan more aggressively now before changes in the law occur (see discussion of Sanders' bill below)?

Proactively Help Clients Plan to Protect Themselves from the Elder Financial Abuse Epidemic

The stats on elder financial abuse may be dramatically worse than many have believed.

- "*Senior citizens may lose nearly 25 times more to scammers than what is reported, according to a report by Comparitech, a consumer research organization based in the U.K. Instead of the 200,000 cases of elder financial abuse that are reported annually to U.S. authorities, the actual number may be as high as 5 million, with losses of $27.4 billion a year, not the $1.17 billion that is officially reported*."
- "*A lot of the financial abuse is perpetrated by family members or people the elderly trust, so they are reluctant to report it; they may be ashamed they got scammed, or they may not realize it…*"
- "*Statistics on the real numbers surrounding elder financial abuse vary by organization, but experts agree it is a serious problem that is debilitating to seniors. An earlier report from the New York City Department for the Aging and Cornell University done in 2011 estimated that only one in 23 cases is reported*."
- "*Comparitech estimated one in 10 people in the United States over the age of 65 falls victim to elder fraud in the last year*.

Practitioners in all the allied professions need to make later life planning and planning with safeguards to minimize the risks of elder financial abuse, a standard part of the planning process. Common planning steps for aging, like preparing a durable power of attorney, need to be rethought in light of these risks. What safeguards can be built in to a durable power and all other aspects of the plan? What monitor relationships external to the document can be created for the client? Might a revocable trust with a trust protector and co-trustees provide a better set of

[4] Simone Foxman, "U.S. Billionaires Are Living Longer Than Ever, Making Heirs Wait," Apr 3, 2019, Bloomberg, https://www.wealthmanagement.com/high-net-worth/us-billionaires-are-living-longer-ever-making-heirs-wait?NL=WM-07&Issue=WM-07_20190408_WM-07_984&sfvc4enews=42&cl=article_6_b&utm_rid=CPG09000005740948&utm_campaign=19709&utm_medium=email&elq2=d0c17deacd1a4f95910e5e559dc3c857

checks and balances? A planning team of independent experts provide additional checks and balances, but that team and its functioning preferably should be addressed in advance of an issue.

The impact of elder financial abuse, inheritance abuse, and similar risks is staggering. Traditional estate planning in many ways still seems mired in the historic view of intact families in first marriages and family loyalty that in many situations is inappropriate or simply does not exist. The common approach of naming spouse then children in age order as agents perhaps should be discussed in detail with clients along with other planning options.

Clients are aging and the incidence of elder financial abuse, and the permutations it can take, are growing as well. A recent article illustrated what appears to be a common occurrence which it dubbed "inheritance exploitation:"[5]

"*After a live-in caretaker was hired to care for his mother full-time, the woman's step-son and other family members were allegedly denied access to their loved one, locked out of the family home and written out of estate planning documents that had originally named them as heirs. By the time the step-son sued for breach of fiduciary duty and financial elder abuse, the caretaker had already pocketed some $5 million, according to a lawsuit filed in the Superior Court of California in Alameda. Although the case against the caretaker was privately settled in mediation last month, the attorney for the plaintiffs, Michael Hackard, warned that cases of inheritance exploitation like this one are on the rise*."

The statistics of those potentially at risk is alarming: "*The number of boomers in their 60s with living parents has risen since 1998 to about 10 million, according to an Urban Institute analysis of University of Michigan data. The Alzheimer's Association estimates that 5.7 million Americans are living with Alzheimer's*."

The article continues on to discuss the role that financial advisors can serve in protecting clients from elder abuse. There is no question that wealth advisers can serve a vital role in protecting clients with these challenges, but to do so more needs to be done then typically occurs. Addressing how that role can be enhanced, and the role of other advisers on the planning team, can reduce the risks of "inheritance exploitation" and elder financial abuse generally.

Financial professionals can restrict distributions from accounts if they have a reasonable belief that the client/account owner is being subjected to financial exploitation under FINRA Rule 2165. The FINRA rule also appropriately broadens the discussion to include not just elderly clients (which most articles unfortunately restrict their discussion to) but clients with other health or cognitive challenges that make them susceptible to abuse. "*...the term "Specified Adult" shall mean: (A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests*."

[5] Juliette Fairley, "What Advisors Can Do About Inheritance Exploitation," Financial Adviser, February 25, 2019 https://www.fa-mag.com/news/what-advisors-can-do-about-inheritance-exploitation-43495.html?section=101&page=2 .

The FINRA rule permits placing a temporary hold on disbursements from the accounts of customers who are believed to be at risk. "*The member [financial adviser] reasonably believes that financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted; and The member, not later than two business days after the date that the member first placed the temporary hold on the disbursement of funds or securities, provides notification orally or in writing, which may be electronic, of the temporary hold and the reason for the temporary hold to: (i) all parties authorized to transact business on the Account, unless a party is unavailable or the member reasonably believes that the party has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult; and (ii) the Trusted Contact Person(s), unless the Trusted Contact Person is unavailable or the member reasonably believes that the Trusted Contact Person(s) has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult; and… The member immediately initiates an internal review of the facts and circumstances that caused the member to reasonably believe that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted. (2) The temporary hold authorized by this Rule will expire not later than 15 business days after the date that the member first placed the temporary hold on the disbursement of funds or securities, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction, or extended pursuant to paragraph (b)(3) of this Rule*."

To best equip a financial adviser to provide this safety net, a number of prerequisites need to be addressed. The adviser must have names and contact data for trusted contact persons to reach out to. But there are many more practical steps that can be taken that too often are not addressed in the planning process. Many of these steps are non-technical practical steps that the entirety of the client's planning team can foster. But these steps are rarely within the primary purview of any single adviser and are not the traditional planning steps most advisers take. But to combat the growing epidemic of financial abuse of elderly and infirm clients need more.

- Perhaps the key step is changing the dialogue. There is not nearly enough focus in financial and estate planning discussions on later life planning. Nor is there the collaboration amongst different professionals robust enough to foster a true team effort in this regard.
- Often clients have many accounts scattered at different institutions. This makes each account less significant to the financial adviser at each firm. It exponentially increases the number of advisers and accounts to address making identification of an issue more difficult. To protect against elder abuse, it may be safer to consolidate accounts at one or two institutions and deepen the relationship with the adviser at the firm (or if really necessary limited numbers of firms) so that the adviser has more contact, more knowledge and hence opportunity to react to a potential elder abuse. This is a difficult or impossible task for a financial adviser to accomplish because the client may view the recommendation to consolidate accounts with that adviser as self-serving. However, if the client's other advisers encourage consolidation (e.g. the CPA, estate planning attorney, etc.) that recommendation may have more impact.
- Get a real financial plan based on a realistic budget completed by the financial adviser. That can provide a touchstone to evaluate suspect transactions. Without a budget and financial plan only the most egregious distributions might be identifiable as

inappropriate. For example, a wire transfer of $100,000 to a Caribbean account pertaining to a supposed lottery winning might be identifiable in all instances. However, if a care worker or family member were to take an elderly client to the cash ATM machine several times a week and slowly pilfer money in that manner, would that be noticeable? Perhaps, not without a budget to compare to historic cash withdrawals. Too many people do not address the fundamental basics of planning which are critical to protecting clients as they age or deal with other health challenges.

- Automate every financial transaction feasible. If most bills are automatically charged to credit cards, credit cards automatically paid from a checking account, and deposits automatically made to the same account a number of protective benefits can be achieved. First, the number of bills, checks and other financial records that arrive by mail can be drastically reduced. That leaves less information for bad actors to abuse. Automating financial transactions reduces the amount of work necessary to pay bills and make deposits, thereby permitting more attention to be given to oversight then working in the financial weeds.
- Automate accounting records on a computer program, e.g. Quicken, so that a CPA or other independent or trusted person can monitor activity remotely. Consider if feasible having an independent firm, e.g. a CPA firm, handle bill pay. That provides a check and balance and independent oversight.
- Encourage clients to use a more robust revocable trust in lieu of relying on a durable power of attorney. Powers of attorney often have one person named agent to act on behalf of the client. That can foster financial abuse if the agent is the person who turns out to be the bad actor. A revocable trust can offer a number of safeguards. You can incorporate co-trustees. While this can be done in a durable power of attorney (and perhaps should be), other steps can include appointing in the trust document a trust protector. This is a person, who may be designated to act in a fiduciary capacity (and under some state laws fiduciary status is the only result), who can be given the authority to remove and replace the trustee if anything is suspected, demand an accounting from the trustee, and more. Other commentators suggest that the trust protector be expressly designated as acting in a non-fiduciary capacity (if state law permits, and if not creating situs and specifying governing law of a jurisdiction that does permit non-fiduciary capacity for the protector). Having a protector as a check and balance for the trustees or co-trustees can be helpful especially for a settlor facing health, cognitive or other challenges caused by aging, or otherwise. Also, consider assigning the revocable trust a separate tax identification number so that accounts are not under the client's Social Security number to make it more difficult for bad actors to identify the account.
- Involve family and others in developing a financial and legal safety net. For example, once financial accounts have been consolidated, have a consolidated statement sent to the client. This can make it easier for even a client with some degree of challenges to stay in control longer as one composite statement of all accounts with that institution can be far simpler to understand than a dozen or more different statements from different institutions. Then have a trusted family member, or if affordable, the client's independent CPA, receive duplicate copies of that statement. If a family member is named, consider naming a person who is not the agent under the client's power of attorney nor the successor trustee of the revocable trust.

- If appropriate to the plan, have consistency between all dispositive documents. The distributions under a will or revocable trust, if agreeable, can match the beneficiary designations under IRA, qualified plans and insurance policies, and so forth. That consistency sets a pattern that could be important if someone endeavoring to commit inheritance extortion or another type of financial abuse is able to have the client change an account title (e.g., to POD to the perpetrator), change a will, etc. Also, consider re-signing the will or revocable trust a few months after the initial document is signed. Add a bequest to a new charity to show that the client considered the document and made a change, but the dispositive scheme other than that remains intact. Consider having different witnesses. That too can create a history corroborating intent.
- Financial abuse of the elderly or infirm appears to be more rampant than statistics can ever identify. So many of these acts are difficult or impossible to identify. Determining whether an elderly parent intended to give more money to a child who claims to have been a caregiver, or whether the purported caregiver was abusing the elderly parent, are difficult to differentiate. Taking proactive steps earlier on, with a collaborative team, looking at practical not just technical implications of planning, can provide more security.

Use Temporary Exemptions Before the Disappear

No Clawback

Regulations were issued confirming that a taxpayer's use of the temporarily enhanced gift tax exemption will not result in a recapture or clawback when the exemption declines.[6] This Regulation emphasizes the advice for many clients to plan now and not wait. Clients, even those of "moderate" wealth, should be investigating transfers to reduce their estates now.

Perhaps Only One (Not Both) Spouses Should Make Gifts

There have been some comparisons to planning in the current tax environment, in which the exemption is slated to decline by half in 2026 (or earlier if the dynamics in Washington change) to those that existed in 2012, when the exemption was slated to decline from $5 million to $1 million in 2013. However, there are important differences and planning is affected accordingly. In 2012 any transfer of more than $1 million preserved exemption. In 2018 transfers might need to exceed the $5.6 million before any benefit of the temporary exemption is preserved. In 2012 planning most irrevocable trusts created to hold gifts and other transfers were structured as grantor trusts. This permitted the transferee spouse to have access and the settlor to borrow trust funds without adequate security. In the 2019 planning environment it may be advantageous to structure some trusts to receive gifts as non-grantor trusts. This may require more complex planning to achieve goals that may be, to some degree, contradictory.

In contrast to 2012 planning, which commonly included each spouse funding a non-reciprocal spousal lifetime access trust ("SLAT"), 2019-2020 planning might differ, and have one spouse

[6] Prop. Regs. 20.2010-1(c); Reg-106706-18.

create a SLAT or perhaps some variant of a DAPT. This might preserve more exemption for future years after the exemption declines.

Example: Husband and wife have a combined estate of $16 million and are willing to make an $8 million transfer to irrevocable trusts to secure a portion of the temporary exemption. If each of husband and wife transfer $4 million to a non-reciprocal spousal lifetime access trust ("SLAT") in 2026 when the exemption declines by half, to perhaps $6 million, each spouse will be left with $2 million of exemption, or a total of $4 million. If instead husband alone transferred $8 million to a trust for wife and descendants, wife would have left her entire $6 million exemption. That would result in usable exemption of $14 million [$8 million used + $6 million remaining]. If instead each spouse used $4 million for gifts and had $2 million each remaining the usable exemption would have been only $12 million, or $2 million less. For taxpayers with estates of a size that there is no need to preserve the new GST exemption, it might be prudent to make late allocations of GST exemptions to existing trusts so that if a future administration rolls back the Act's benefits, those trusts will already be exempt.

Variations of Domestic Asset Protection Trusts ("DAPTs") May Be Vital For Moderate Wealth Clients to Preserve Exemption

Modern trust planning techniques provide an array of options to permit a client to benefit from assets transferred to completed gift trusts that can use exemption. These include: DAPTs,[7] hybrid-DAPTs where someone in a non-fiduciary capacity can name the settlor as a beneficiary, special powers of appointment to direct a trustee to make a distribution to the settlor,[8] variations of non-reciprocal SLATs, loan powers, floating spouse-clauses, etc. If clients can have access to the assets transferred, what is the impediment to proceed with planning in light of the risks posed by Sanders proposal? In fact, because effective estate tax planning although always requires assets be removed from claims of the client[9], this planning may benefit him or her, as well as his or her family. That may be a calculus many moderate wealth clients have viewed quite differently with the current high exemptions. But that perspective should be reexamined.

The need to use self-settled domestic asset protection trusts ("DAPTs"), or variations of DAPTs, to provide clients access to the large wealth that must be transferred to secure some portion, or all of the current large exemptions has increased post-Act.[10] At the same time, there seems to be concern among some practitioners about the efficacy of this technique. Practitioners need to understand the issues to guide clients to make informed decisions about the use of DAPTs and variants, but to also give clients the comfort level to proceed with planning that could prove valuable.

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[7] See: PLR 200944002. See: Shenkman and Rothschild, "Self-Settled Trust Planning in the Aftermath of the Rush University Case," Steve Leimberg's Asset Protection Newsletter No. 215 Dec. 6, 2012. This evaluates another negative DAPTs case and also provides an historical overview of self-settled trusts.

[8] O'Connor, Gans & Blattmachr, "SPATs: A Flexible Asset Protection Alternative to DAPTs," 46 Estate Planning 3 (Feb 2019).

[9] See, e.g., Rev. Rul. 2004-64, 2004-27 I.R.B. 7

[10] For application of DAPTs to premarital planning, which has many similar concepts relevant to the discussion herein, see: Glazier, Shenkman and Gassman "DAPTs & Klabacka - At the Intersection of Estate Planning and Family Law," LISI Asset Protection Planning Newsletter #357 (February 1, 2018).

Self-settled domestic asset protection trusts ("DAPTs") may be more important in the current planning environment than in prior years. Access to assets to be transferred to use the temporary large exemptions is critical for most clients other than UHNW clients who have so much wealth that they are unconcerned about retaining direct access to assets transferred. For single clients, and even many married clients, they will want or insist on being able to access the assets transferred. With historically high exemptions very large transfers relative to the net worth of moderate wealth clients (perhaps defined as $5 million to $40 million) may be necessary to make a meaningful impact on securing the large temporary exemption. This will have consequent impact on due diligence, solvency affidavits, financial forecasts prior to transfers, etc.

When evaluating the possible use of a DAPT practitioners should consider the recent DAPT cases, such as *Wacker*.[11] While some commentators have concluded that DAPTs are no longer viable post-Wacker, that seems an inappropriate conclusion, although there are certainly risks and uncertainties involved. The Wacker case, as many DAPT cases, was a bad fact case that should not inhibit the use of DAPTs, although alternative approaches and structures to lessen possible risks appear to be more commonly used. Some commentators view the Wacker case as quite limited and that it does nothing to change the risks of the use of DAPTs, even by those residing in non-DAPT jurisdictions. Rather, they view Wacker as a limited case addressing jurisdiction, and another warning that no type of trust, self-settled or otherwise, can protect against a fraudulent conveyance.[12] The Supreme Court of Alaska held that Alaska could not require that proceedings relating to the transfer of assets to an Alaska self- settled trust be exclusively before an Alaska court. It did not invalidate self-settled trusts created in that state.

A common-sense precaution that should be used in all instances is to take proactive steps to corroborate that the trust and transfer to it are not fraudulent conveyances. These might include:

- Conduct lien and judgement searches.
- Conduct and corroborate other due diligence steps.
- Have the transferor sign a solvency affidavit whether or not state law requires it.
- Obtain forecasts by the client's wealth adviser demonstrating no anticipated need to access the DAPT assets.
- Assure reasonable life and long-term care insurance coverage is in place pre-transfer.
- Assure that a reasonable personal excess liability policy (umbrella) is in force before a transfer.

In the current environment even DAPT proponents seem to suggest a wide array of variants of the traditional DAPT technique to provide more security.

[11] Toni 1 Trust v. Wacker, 2018 WL 1125033 (Alaska, Mar. 2, 2018).

[12] Blattmachr, Blattmachr, Shenkman & Gassman on Toni 1 Trust v. Wacker - Reports of the Death of DAPTs for Non-DAPT Residents Is Exaggerated, Steve Leimberg's Asset Protection Planning Email Newsletter Archive Message #362, Mar. 18, 2018.

- Incorporate as many restrictions on the grantor being a beneficiary into the trust as agreeable by the client, e.g. the client will not be entitled to any distributions unless the client has no spouse.
- One popular approach is referred to by some as a hybrid DAPTs in which the descendants of the settlor's grandparents can be added back as beneficiaries in the discretion of a person named to act in a non-fiduciary capacity. But if someone holds this power to add a beneficiary the DAPT will be characterized as a grantor trust which may not be desirable in some instances post-Act. Practically, what this might mean, as noted above in other examples, is a combination of various trusts (grantor and non-grantor, as well as other characteristics) tailored to the particular client's situation.
- If the trust is drafted as a third-party trust (that is, one not created by any beneficiary), and not a DAPT, but a general power of appointment ("GPOA") is provided to a senior family member, that GPOA can be exercised in favor of an appointment to a trust that includes the original trust's settlor/grantor as a beneficiary. That should not be characterized as a DAPT as the exercise of a GPOA probably should characterize the power holder, not the initial settlor, as the transferor.
- Another approach is to permit a person named in a non-fiduciary capacity to direct the trustee to make a distribution to the settlor. In this way the settlor is a beneficiary. This should not characterize the trust as a grantor trust.[13]
- Loan provisions may provide a means of access before turning on DAPT status. But if the loan is not for adequate security or adequate interest grantor trust status will ensue.
- Another approach is to draft limitations into the governing instrument. For example, no distributions can be made to the Grantor for ten years and one day after transfers are made to the trust to address the rights of a bankruptcy trustee to disavow a self-settled trust.[14] Some practitioners provide that the Grantor cannot be added or appointed to be a beneficiary unless there is a divorce or death of a spouse.

For those still concerned about the use of self-settled trusts, and this comment is not meant to negate those concerns, it is noteworthy that the number of states with self-settled trust legislation continues to expand. Connecticut is the most recent state, perhaps the 20th, to allow for asset protection trusts. On July 12, 2019, the Governor of Connecticut signed the Connecticut Uniform Trust Act, which includes the Connecticut enabling statute for a qualified disposition statute.

Enhanced Note Sales to Grantor Trusts ("IDITs") for UHNW Client Wealth Transfers

Ultra-high net worth ("UHNW") clients should be planning aggressively in the current tax environment and before the possible risk of a change in power in Washington after the 2020 election. Should there be such a change, and should the Democrats obtain sufficient control, they may well enact estate tax legislation based on the Sanders tax proposal discussed below. That

[13] It may be feasible to create a non-grantor DAPT. Makransky v. Comm., 321 F.2d 598 (3rd Cir. 1963).
[14] Bankruptcy Protection Act

could emasculate estate tax minimization planning. It might effectively eliminate GRATs and discounts, cause inclusion of grantor trust assets in the settlor's estate, have GST tax assessed on trust assets after 50 years, and more. Completing comprehensive planning now may be vital to the preservation of the UHNW client's estate. A common planning technique for freezing and shifting large wealth is a note sale to a grantor trust. The following discussions suggest nuances of structuring such transactions, including several possible enhancements to perhaps make the transactions more secure, and perhaps to minimize the risks posed by the recent Powell decision. The differences in opinions about various planning techniques used for UHNW clients consummating large wealth transfers are fascinating to consider. These variations highlight the uncertainty of UHNW client planning, and perhaps opportunities to refine and improve planning techniques.

Create a New Grantor Trust as to an Existing Irrevocable Trust to Freeze Values and Enhance GST Benefits While Feasible ("BDOT")

UHNW taxpayers may have large assets, including family business interests, held in a marital or QTIP trust (or other irrevocable non-grantor trusts) that may not be GST exempt. In light of the risks of the 2020 election might hold, it may prove advantageous to shift assets out of a non-GST exempt trust into a GST exempt trust. For example, if future legislation eliminates discounts on the assets held in the QTIP or other trust, selling those assets to a grantor trust today could prove advantageous.

Example: UHNW clients if they have, for example, large non-GST exempt trusts, might create new GST exempt trusts. A family member may create a new irrevocable trust that is an IRC Sec. 678 grantor trust as to the existing non-GST exempt trust, funding that new trust using a portion of her new gift and GST exemption. That new trust could be designed by its terms to be grantor as to the old non-GST exempt trust. Then the old non-GST exempt trust could engage in transactions to shift value to the GST exempt trust, before the laws change unfavorably. One approach to this might be for the non-GST exempt trust to sell assets in a note sale transaction to the new GST exempt trust thereby freezing the value in the non-GST exempt trust. Some have referred to this as a Beneficiary Deemed Owner Trust ("BDOT").

This could be a useful planning tool but at present there is limited guidance. Two trusts and one trust deemed the owner of the other trust for income tax purposes under the grantor trust rules.[15] This creates the opportunity to facilitate transfers between new parties, e.g. beneficiary and testamentary trust deemed grantor under IRC 678(a)(1). This 678-Trust or BDOT is quite different than the technique of a Beneficiary Defective Irrevocable Trust ("BDIT"). In the BDIT a Crummey power is granted to the beneficiary to create grantor trust status as to that particular beneficiary. In contrast the Code Section 678 trust relies on a different mechanism to create grantor trust status as to the existing or old trust: "A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself…"[16] In one case, the beneficiaries held the power under Code Section 678 to demand that the trustee

[15] PLR 201633021.
[16] Code Section 678(a)(1).

distribute capital gains to them. Regardless of the fact that the power was not exercised, the beneficiaries where characterized as deemed owners of the trust.[17] While some have suggested that if a settlor (e.g., a parent) creates an irrevocable trust which provides the beneficiary, such as a child of the parent,, the right to withdraw all taxable income, it will be characterized entirely as a 678 trust as to the beneficiary child. The same could be done with two trusts. If the new trust is fully grantor as to the beneficiary/child that child could engage in a large sale to the grantor trust income tax free. Further, some have suggested that on the death of the child only the taxable income which the beneficiary/child has not withdrawn is included in his or her estate. However, it is suggested that, perhaps, the entirety of income or corpus of a new trust should be subject to a withdrawal power by the trustee of the existing trust to fully assure grantor trust status for the entirety of the new trust.

The terms of the new trust should give the existing trust the right to withdraw ordinary income and capital gains and that characterizes the existing/old trust as the deemed owner of the new trust. While some have suggested that the right to income alone might characterize the existing trust as grantor as to the new trust, others believe that a safer approach might be to give the trustee of the existing trust the right to withdraw income or principal to assure grantor characterization

Consider "Stepped" or Deferred Interest to Facilitate A Larger Sale then Current Cash Flow May Permit

Assume a client is going to engage in an installment note sale to a grantor dynasty trust (which may be referred to as an Intentionally Defective Irrevocable Grantor Trust or "IDIGT").[18] But the entity whose interests are being sold has current cash flow needs for business research and development. As a result, distributions will be difficult/limited for several years.

Might the purchasing trust backload the scheduled payment dates of the interest that accrues under the term of the note? So, for example, during the first X years of the note, the purchaser will pay interest every year at a rate of say 1%. The remaining and unpaid 2% interest (assuming a 3% AFR) will compound at the same 3% AFR rate until it is paid. Thus, the note will have negative amortization during the first X years of its term. After the first X years, the purchasing trust will pay the full interest that accrues every year on a current basis (or if advisable from a cash flow perspective another "step" in rate can be used). During the remaining term of the note, the purchaser also will pay the compounded shortfalls in interest payments that arose during the first X years of the note.

Because the debtor trust under the note, the purchaser, will not have sufficient cash flow to currently pay all the interest that accrues during the first X years of the note, it might be argued that the purchasing trust could be characterized as "thinly capitalized." So, practitioners considering such a note structure should confirm and corroborate that thin capitalization is not an issue as that might undermine the validity of the debt itself and hence the transaction. Thus, there

[17] Campbell v. Commr., TC Memo 1979-495.

[18] Portions based on: Shenkman and Blattmachr: "Estate Planning Updates and Planning Nuggets January - April 2019," Estate Planning Newsletter #2728 (June 4, 2019).

should be no issue as to whether the note will be respected as debt or whether it could instead be characterized as equity. The issue of the trust not being "thinly capitalized" will depend on a current balance sheet of the trust reflecting the current appraised value of assets it owns.

The delayed payment during the first X years of the note of the interest that accrues should not by itself cause the note that the purchaser gives to the seller to be recharacterized (e.g. as an invalid indebtedness, a gift, as equity instead of debt, etc.).

Using variable interest should not itself undermine the validity of a note. If a loan requires payments of interest calculated at a rate of interest based in whole or in part on an objective index or combination of indices of market interest rates (e.g., a prime rate, the applicable federal rate, the average yield on government securities as reflected in the weekly Treasury bill rate, the Treasury constant maturity series, or LIBOR (London interbank offered rate)), the loan will be treated as having sufficient stated interest if the rate fixed by the index is no lower than the applicable federal rate (1) on the date the loan is made, in the case of a term loan, and (2) for each semiannual period that the loan is outstanding, in the case of a demand loan.

For term loans, determining the appropriate AFR is simply the use of an interest rate that is equal to the AFR with the same compounding period for the month in which the loan is made. For sale transactions the appropriate AFR is based not on the term of the note, but on its weighted average maturity.

Code Sec. 7872, which created new rules for the tax treatment of loans with below-market interest rates, went into effect on June 6, 1984. The scope of this code section and its application for gift tax purposes were addressed in Frazee. The Tax Court determined that the Code Sec. 7872 applicable federal rate ("AFR"), and not the Code Sec. 483(e) six-percent interest rate, was controlling for gift tax valuation purposes. Accordingly, because the intra-family sale of real property in Frazee was not a bona fide arm's-length transaction free of donative intent, the court held that the excess of the face amount of a note bearing seven-percent interest over its recomputed present value, using the applicable federal rate for long-term loans, constituted a gift of interest.

Code Sec. 7872 applies to any transaction that (1) is a bona fide loan, (2) is below market, (3) falls within one of four categories of below-market loans, and (4) does not qualify for one of several exceptions. The four categories are loans (1) from a donor to a donee, (2) from an employer to an employee, (3) from a corporation to a shareholder, and (4) with interest arrangements made for tax avoidance purposes.[19] The below-market-rate demand loan is a two-step transaction:

- The lender treated as having transferred on the last day of the calendar year an amount equal to the forgone interest (the prevailing federal rate of interest less the loan's actual interest rate) to the borrower; and
- The borrower/trust is then treated as retransferring that amount back to the lender as imputed interest.

[19] Code Sec. 7872(c); Code Sec. 7872(a)(1).

What if the loan provides adequate interest so that it is not a below-market loan? There is no forgone interest to report under Code Sec. 7872. But if the note provides for the interest to accrue and is not paid, the original issue discount (OID) rules will apply. The OID rules do not apply merely because interest that is to be paid currently is not paid. They only apply where there is accrual/deferral by the terms of the note. The OID rules would have the taxpayer report a pro rata amount of the overall mount of the OID over the life of the loan using a constant yield method under the Regulations under Code Sec. 1272. But on a sale to a grantor trust the OID complications appear to be obviated at least until grantor trust status terminates. So, while these rules should apply, they should have no income tax significance.

Different variations can be devised based upon needs of the parties. Consider:

- Have interest accrue at different rates during the term of note instead of being paid at different rates. To clarify, the above discussion concerns accruing interest ratably over the note, just providing for payment at a different schedule.
- Pay interest that cannot be paid in cash by issuing a note from the borrower/trust for any unpaid interest. There does not seem to be any consistency in views as to whether this will make the note more problematic to support on audit. One view is that there is nothing prohibiting paying a note interest payment in-kind, e.g. with another note. The opposing view is that this might make the transaction appear uneconomic in contrast to "baking in" the cash flow considerations from inception, e.g. with a stepped note.

Be Wary of the Hart Scott Rodino Act Requirements

Practitioners should be mindful that large estate planning transactions may trigger reporting requirements under Hart-Scott-Rodino Antitrust Improvements Act ("HSR").[20] HSR imposes an obligation to file a premerger notification report form with the Premerger Notification Office of the Federal Trade Commission ("FTC"). This may all be counterintuitive since a sale of interests in a closely held or family business to a trust created by the family can hardly be viewed as negatively impacting competition, but meeting the filing requirements, or finding an exemption, is necessary to avoid potential onerous penalty provisions.

Acquisitions resulting from a gift, intestate succession, testamentary disposition or transfer by a settlor to an irrevocable trust may be exempt from the filing or other requirements of HSR.[21] However, the conclusion may not be simple or assured and practitioners should consider consulting with an expert in these matters. There could be an impact on the HSR determination based on trustee and trust protector provisions included in the trust instrument, and, specifically, who should have the ability to remove and replace trustees.

- A settlor's retention of the ability to remove and replace the trustee, or the right of a trust protector to do so, of an irrevocable trust might cause the trust's voting securities to be treated as part of the settlor's ownership share of an entity for purposes of HSR testing.

[20] See Jay D. Waxenberg and Jason A. Lederman, "The intersection of trusts and anti-trust: Why you, an estate planner, should care about Hart-Scott-Rodino," 51 real Property, Trust and Estate Law Journal, at 431.
[21] Sec. 802.71.

- If the trust protector of a trust has the contractual power to remove and replace 50 percent or more of the trustees, the protector may be considered a control person. Pursuant to informal conversations with the FTC staff that power of the trust protector must be absolute and not, for example, merely the power to name a successor trustee without the power to remove, and not in instances where the power to remove and replace is subject to consent of a third party.
- In testing HSR filing requirements, holdings of spouses are considered to be the holdings of each of them.[22]

The company is its own Ultimate Parent Entity ("UPE") in that no other entity "controls" it; and after the acquisition, and the protector might be viewed as in "control" of the entity by virtue of holding 50% or more of its voting securities. In addition to control meaning holding 50% or more of voting securities, there is an alternative control test for control of corporations of having the contractual power presently to designate 50% or more of the directors. If a person did hold that power that person may be viewed as the UPE or, post-acquisition, a UPE in addition to the protector. Inquiry might be appropriate as to whether an investment advisor (investment trustee) in a directed trust who can vote the equity interests might thereby be classified as a UPE based on the above. This nonetheless may not affect the HSR analysis as to whether an exemption applies.[23]

If the exemption does not apply and filing is required, the protector or perhaps investment trustee may be considered the "acquiring person" and the company (since it is currently its own UPE) would be the "acquired person". Should that occur then perhaps both the trust protector and the company could be required to file. There would be one filing fee which would be based on the value of voting securities of the company that the protector would "hold" as a result of the acquisition (both what is currently held and what is being acquired). The filing fee would be based on the size of the transactions.

An informal opinion might be obtained from the FTC as to whether a proposed transaction, e.g. a note sale transaction to a grantor trust, is exempt under Sec. 802.71 even though the transfer would meet the HSR size of transaction and size of person tests.

The FTC may not dispute the proposition that essentially internal, estate-planning-driven transfers of family businesses to a trust should be exempt, while acquisitions by a trust from third parties should not.

There is no reason why the government should be concerned about a family transaction as this has nothing to do with significant businesses combining. The regulators may respond that they do not think that trust protector status is significant. Nonetheless, any time a large transaction is contemplated, a mergers and acquisition specialist should be involved to parse through the HSR exceptions to confirm no filing needed.

[22] Sec. 801.1(c)(2).
[23] Sec. 802.71.

Mix Up the Collateral to Possibly Break IRS Challenges of a Retained Interest on a Note Sale

When selling assets to an existing irrevocable trust that has already benefited from prior planning another planning option might be to consider using assets other than the assets being sold in the current transaction as collateral.

Example: ABC, LLC interests were sold to a trust years ago and that transaction has been completed and any note repaid. Now, the taxpayer is contemplating selling XYZ, LLC interests to the same trust. Instead of using XYZ, LLC interests as collateral on the note the trust gives the selling taxpayer, what if instead ABC, LLC interests are used as collateral for the note? Might that reduce the potential strings attached to the asset sold which could cause estate tax inclusion?

What if a guarantee is used and the terms require that the seller/lender/donor must first proceed against the guarantor before proceeding against the collateral? While unconventional, might that create more distance from the asset sold if there is no other collateral to use? How would the guarantee fee have to be adjusted to reflect this increased risk? Since the guarantor would be first "in line" before the collateral the fee to be charged would have to be greater than in a traditional guarantee arrangement.

Defined Value Mechanisms Might be Enhanced and Modified for New Planning

Can the potential gift tax risk of a large transaction be minimized? Large transactions often include mechanisms to minimize current gift tax risk. But there seems to be less agreement on how to structure such arrangements then might be anticipated. For UHNW clients pursing current large dollar planning, using some variation of these mechanisms may warrant consideration. Some transactions are structured using some application of one of the key defined value cases.[24] These types of mechanisms are based on the entirety of the intended value being transferred away from the transferor. However, if there is an excess value over what the buyer in the transaction is paying, as a result of an IRS audit adjustment, that excess value is poured into a non-taxable receptacle. This non-taxable receptacle could be a charity (but be cautious if a private foundation is used, it may not be feasible), a grantor retained annuity trust ("GRAT"), marital trust, or an incomplete gift trust. However, as with many aspects of planning there is less agreement amongst practitioners as to which spillover or structure is best. Practitioners will have to weigh the options in evaluating UHNW transfer planning.

What Type of Price Adjustment Mechanism Might You Use?

The King case might provide a planning option to consider.[25] The King case upheld the use of a price adjustment clause.

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[24] McCord, CA-5, 2006-2 USTC ¶60,530, Petter Est., 98 TCM 534, TC Memo. 2009-280 or Christiansen Est., 130 TC 1, CCH Dec. 57,301, aff'd CA-8, 2009-2 USTC ¶60,585

[25] J. King, CA-10, 76-2 USTC ¶13,165.

Example: Simplifying, this might be as follows. Taxpayer hereby transfers $100 worth of stock to XYZ trust for a note. If the value of the stock is finally determined for gift tax purposes to be greater the face amount of the note shall be adjusted accordingly.

Some practitioners believe it works and indicate that they have used a King type price adjustment clause many times. Some practitioners report what they described as favorable results on audits using this approach. Others suggest less optimistic results. Some practitioners are simply not comfortable with a King type approach. Some object to King based on the structure of the adjustment. For example, might the adjustment of the note be viewed as an impermissible condition subsequent under Procter? Some view it as an "outlier" not to be relied upon because it is only a 10th Circuit case. The Ward case rained a bit on the King parade according to some views.[26] A variation of a traditional King type approach might be for the note's face value to be defined as being the gift tax value as finally determined.[27] Does this negate a challenge under Procter?[28]

Wandry might present another option to consider as part of the efforts to minimize gift tax.[29] In the Wandry case the tax court upheld an approach that relied on the transfer of a fixed value of assets to a trust rather than a specified portion of equity.

Example: Simplifying, this might be as follows. Taxpayer hereby transfers $100 worth of stock to XYZ trust. While many practitioners prefer a Wandry approach to a King approach the IRS has non-acquiesced to the Wandry decision.[30] Thus, in a "traditional" Wandry clause the taxpayer may transfer a fixed dollar amount of shares only. Another variation of a Wandry approach is to have the beneficiaries of the buying trust executing a disclaimer of any value in excess of the specified value. The concept is that this would make it difficult for the IRS to argue more was transferred if the recipient trust were prohibited by the disclaimer from accepting the incremental value.[31]

Consider a Two-Tiered Wandry to Deflect a Powell Challenge

There might be a different variation of a Wandry clause that might be useful in certain circumstances. In particular, if the transferor must transfer all shares at the closing, can the typical Wandry clause be improved upon? What might be dubbed a "Two-tiered Wandry" may provide a planning solution. A "two-tier Wandry" arrangement would consistent of a two-part transaction: a traditional Wandry transfer, followed by a simultaneous sale of any shares (or other assets) left by the Wandry adjustment clause if it is triggered. There may be income tax or contractual reasons for the need to transfer all equity. The problem with a Wandry clause is that it could leave shares in the selling taxpayer or trust's hands, which may not be desirable for

[26] C. Ward, 87 TC 78, CCH Dec. 43,178.
[27] This idea is attributed to Steven Gorin, Esq. Gorin, part III.B.3.a.iv. Defined Consideration Clause, "Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications" (printed 7/14/2019), available by emailing the author at sgorin@thompsoncoburn.com.
[28] Comm'r v. Procter, 142 F.2d 824 (4th Cir. 1944), cert. denied, 323 U.S. 756 (1944).
[29] Wandry et al., 103 TCM 1472, CCH Dec. 59,000(M), TC Memo. 2012-88.
[30] IRB 2012-46.
[31] This idea is attributed to Stacy Eastland.

business or personal reasons. This could create uncertainty with respect to the trust's ESBT status if all S corporation shares are sold but the operation of a Wandry clause results in shares having remained in the trust. For example, does the ESBT election end when all shares are sold? If so what occurs when it is later determined that S corporation shares are held in the selling trust? The second tier of the Wandry arrangement would consist of a second sale of any shares, effective as of the same date as the primary Wandry sale, that remain in the selling taxpayer or trust's hands. The price for this second sale, if any, would be for a price equal to the gift tax value as finally determined. This second tier Wandry sale would be supported by a note for that on which interest would accrue from closing and be made current within a specified time period, e.g., 90-days of the final determination.

Incorporate an Economic Adjustment Mechanism in Your Defined Value Technique

Inherent in many defined value mechanisms is that an adjustment might be made at a future date as to which taxpayer owns the particular assets (e.g., stock in a closely held business or an LLC interest) from the inception of the transaction. While defined value mechanisms routinely address the allocation of these equity interests, how are the economic implications of the adjustment provided for? If five years pass from the date of a transaction until the interests sold are determined definitively, how are the economic consequences of that five-year period addressed? This might include dividends or distributions that need to be repaid from the recipient to the correct party, e.g., the seller. Also, what mechanism will be used to assure that the equity interests are properly adjusted? Would merely providing for an adjustment clause alone suffice? Consider the following possible approach illustrating provisions when the valuation adjustment mechanism uses a spill-over of excess value to a grantor retained annuity trust ("GRAT") described in Reg. 25.2702-3.

Sample Economic Adjustment Clause Between Buying Trust and GRAT: "A reallocation of funds may be required as a result of any reallocation of the Shares from the Buyer to the GRAT under the economic adjustment provisions of the Transfer Agreement following an initial adjustment (e.g., an income tax audit). A second reallocation of funds may be required as a result of a second adjustment to the allocation of the Shares from the Buyer to the GRAT following a second and final adjustment (e.g., a gift tax audit following an initial income tax audit). It is understood that the Escrow Agent shall not release any of the Shares to the Buyer or the GRAT until the Buyer and the GRAT: (i) acknowledge in a written document acceptable to the Escrow Agent (the "Escrow Release") that pursuant to the terms of the Transfer Agreement, the Buyer and the GRAT have determined the number of Shares to be sold to the Buyer (i.e., the Actual Sale Shares) and the number of Shares to be gifted to the GRAT (i.e., the Actual Gift Shares) and (ii) set forth in such Escrow Release instructions directing the Escrow Agent as to the number of Shares that are to be released to each Party…. It is understood that the CPA Report will corroborate the amount of dividends, other distributions, or other economic benefits that accrued to the Buyer prior to the Distribution Date (as defined in the Transfer Agreement), and that are properly allocable to the GRAT, if any. The Escrow Agent shall not submit the Existing Stock Certificate, the Sale Stock Power or the Gift Stock Power to the Corporation (or its transfer agent) pursuant to Section X until after the Escrow Agent receives written notice signed by the Buyer and the GRAT, in form and substance satisfactory to the Escrow Agent, that the Buyer has reimbursed the GRAT, or made adequate arrangements to reimburse the GRAT as permitted

under the Transfer Agreement, for any amounts payable to the GRAT pursuant to the CPA Report."

Consider Using a Two Tier Defined Value Adjustment on Sales to Non-Grantor Trusts

The use of non-grantor trusts may have application beyond planning post-Act to garner income tax benefits. A sale to a grantor trust would be essential if there is significant gain in the assets being sold, to avoid recognition of gain. Also, use of a grantor trust provides continued tax burn, and the ability to exercise a swap or substitution power which could be indispensable to basis step-up planning (by trading high basis assets the grantor owns for low basis assets in the trust, before the grantor dies). But in some instances, use of a non-grantor trust might be advantageous as the buyer in a note sale or other transaction, even if unusual. The basis step-up on the death of the first spouse might permit avoiding capital gain on a sale. Also, an old no-longer grantor trust may have substantial assets and avoid the need for seed gifts or guarantees and make the perceived risk of the transaction lower.

How should a defined value mechanism be structured for such a transaction? It would appear that a two-tier defined value mechanism would be necessary to address both income tax audit results as well as gift tax audit results, since a sale to a non-grantor trust could trigger both income and gift tax audit adjustments. The income tax audit adjustment could be based on an IRS argument that the value of the asset (e.g., stock in a close corporation) was understated so that the transaction is in reality a part gift/part sale with less shares having been sold. This adjustment could be independent from a later gift tax audit that argues that the valuation was low, and hence a gift made. Thus, in contrast to the economic adjustment clause illustrated above for a sale to a grantor trust, a two-tier adjustment might be necessary to conform the economics to the ultimate result of the transaction.

Sample Clause: "The Parties acknowledge that a second economic adjustment may be required if there is a second tax adjustment (e.g., a gift tax audit following an earlier income tax audit at which time an adjustment was made). Should this occur, the Parties further agree to take any and all reasonable additional actions, and to execute any additional documents, in order to effectuate such adjustment payments, as the Accountant determines appropriate, if any."

An escrow agreement governing the holding of transfer documents might address both the income and gift tax audit which would impact the release of equity as well as the holding of equity as security for the note.

Sample Clause: "Allocation of the Shares. The Shares shall be held by the Escrow Agent pending the events necessary for the Shares to be valued, which may occur in two tranches, resulting from an income tax audit and a gift tax audit. As a result of that valuation process, the Parties shall determine, pursuant to the Transfer Agreement, the number of Shares that shall be deemed sold to the Buyer effective as of the date hereof (the "Actual Sale Shares") and the number of Shares that shall be deemed gifted to the GRAT (the "Actual Gift Shares")…All of the aforementioned steps are independent of the events associated with the repayment of the Secured Promissory Note (as defined herein)."

Since the buyer is a non-grantor trust it may have incurred income tax as a result of distributions, dividends or other economic consequences while holding business interests it purchased pending a final determination of the gift tax value and the adjustment to reflect that result. Does this tax cost get factored into the economic adjustment clause concept discussed above?

Divide a QTIP Before Implementing a Plan to Possibly Contain the Risk of a 2519 Challenge

The transfer of the qualifying income interest of the spouse is a transfer by the spouse subject to gift tax under § 2511.[32] If the IRS were to successfully assert a 2519 transfer, the entirety of a Qualified Terminable Interest Property ("QTIP") trust would be deemed transferred with potentially significant gift tax consequences for UHNW clients (for lesser wealth clients the current high exemptions might eliminate any tax cost to a 2519 challenge and hence make this otherwise worrisome tax challenge an affirmative planning tool).

The draconian consequences a successful Code Section 2519 challenge could have to a client transaction suggest that if steps can be taken to insulate or minimize that risk, or in some instances alternate planning structures used, it might be advantageous. If a sale is to be made by a trust that is part of a QTIP trust, perhaps steps can be taken to insulate the remainder, or main QTIP trust. A 2014 PLR provides a suggestion as to how, in part, this 2519 insurance might be obtained. [33] The concepts in the PLR might be extended further to provide insulation to different types of estate planning transactions.

The PLR provided as follows: "*Decedent's executor elected to treat Marital Trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code...The trustees of Marital Trust propose to divide Marital Trust into three separate trusts, Trust 1, Trust 2, and Trust 3. The terms of Trust 1 will be identical to the terms of Marital Trust. Following the division, the trustees intend to convert Trust 2 to a total return unitrust with an annual unitrust payment equal to not less than three percent or more than five percent of the fair market value of the assets of Trust 2 determined as of the first day of each taxable year. The trustees, with the consent and joinder of the trustees of Family Trust and Decedent's children, will petition Court for a court order to terminate Trust 3 and distribute the assets of Trust 3 equally to Decedent's children…the division of Marital Trust into three separate trusts each separate trust will be a QTIP trust under § 2056(b)(7) and the division will not be a deemed gift or other disposition under § 2519.*"

But the division of marital trust might be used more proactively to insulate against an IRC Sec. 2519 attack if the QTIP trust is selling an asset. Assume, for example, that an irrevocable trust that qualifies as a QTIP trust is, pursuant to the terms of the governing instrument, to be combined or poured into a QTIP trust. If that first trust is to engage in a sale or transaction that might pose any 2519 arguments, perhaps the two QTIPs can be bifurcated to prevent a 2519 attack from reaching the second QTIP. The same governing instrument might include powers to divide trusts and even not to merge trusts. "Whenever two trusts created under this Will are

[32] Section 25.2519-1(a).
[33] See PLR 201426016.

directed to be combined into a single trust (for example, because property of one trust is to be added to the other trust). The Trustee is authorized, in the exercise of their sole and absolute discretion, instead of combining said trusts, to administer them as two separate trusts with identical terms in accordance with the provisions that would have governed the combined trusts." It may be feasible for the trustees of each of the QTIP trusts to exercise these powers in advance to prevent merger and to otherwise administer the trusts as independent and separate QTIP trusts. If an institutional trustee is named in any of the QTIP trusts it may be feasible for the institution to confirm the action to prevent a merger of the separate QTIP trusts to provide greater independence to the transaction then if merely family members approved the transaction. This affirmative action prior to consummating a transaction may make it difficult or impossible for the IRS to assert a 2519 challenge against the QTIP trust that did not engage in the subject transaction.

Use of an Independent Escrow Agent

If a sale occurs subject to a defined value mechanism and/or a deferred payout supporting the note, who holds the collateral for the note? Who holds what documentation pending the resolution of the defined value mechanism? In most cases these documents are held by the estate planner crafting the transaction. Might there be a better option? The Ward court noted: "Furthermore, since there is no assurance that the petitioners will either recover the excess shares or, at the time of their deaths, possess the power to recover such shares, and since the shares are not worthless, the petitioners' estates may be reduced by the transfer of the shares."[34] Might having title documents held in the hands of an independent escrow agent's hands assuring that the adjustment has to be made, deflect this concern? Using an independent law firm, not a firm otherwise involved in the transaction, with a detailed escrow agreement specifying which documents should be held, and how they should be handled, might add additional credibility to the arrangement and negate the issue raised by the Ward court. Endeavoring to adhere to all relevant formalities could be important.

In the Wandry case the taxpayers listed percentage interests on the schedules attached to the gift tax return, not dollar figures as would have been consistent with the transfer of a fixed dollar amount. While the Court did not change its conclusion because of this issue, it is certainly better to avoid such inconsistencies. Adhering to the formalities of a detailed escrow agreement, one reviewed along with all documentation by an independent agent, may also help safeguard transactions from these issues.

Use Non-Grantor Trusts for Planning Benefits

Use Non-Grantor Trust for Asset Protection Planning for Moderate Wealth Client

Asset protection considerations of non-grantor trusts deserve additional attention post-Act. With moderate wealth clients not facing any federal estate tax, unless they are domiciled in a decoupled state that could result in a state estate tax, there may be no transfer tax benefit to

[34] The Ward Court referenced See Harwood v. Commissioner, 82 T.C. at 275 n. 28. Ward v. Comm'r., 87 T.C. 78 (1986); Rev. Rul. 86-41, 1986-1 C.B. 300. Cf. King v. U.S., 545 F.2d 700 (10th Cir. 1976).

creating a grantor trust plan that affords asset protection, e.g. a DAPT or non-reciprocal SLATs for married couples. It may only be the income tax benefits afforded by a plan based on non-grantor trusts that offers a non-asset protective rationalization for the planning.

Example: Physician has a net worth of $12 million. Prior to the Act the couple faced a federal estate tax. Shifting assets to non-reciprocal spousal lifetime access trusts ("SLATs") would likely save estate tax, and that tax savings would likely grow as the estate grew. However, post-Act the same couple would realize no estate tax benefit from creating non-reciprocal SLATs. Perhaps, there is no other justification for the plan other than asset protection. However, if a non-grantor trust were instead created, and state income tax, SALT and other income tax savings are realized, those income tax savings might lend support to the non-assets protection motives for the trust.

Create A Non-Grantor Trust for Charitable Contribution Deductions for Moderate Income Client

Charitable planning will change considering the Act in many ways. One potentially significant transformation will be an increased use of non-grantor trusts. Most taxpayers will not exceed the new standard deduction threshold thereby losing tax benefits of charitable giving. The doubling of the standard deduction to $24,000 for a married couple has been estimated to lower charitable giving by $13 billion+ per year. The doubling of the estate tax exemption to more than $11 million has been estimated to lower charitable giving by $4 billion per year.[35] Creative tax planning, and emphasizing non-tax benefits, may help offset some of this loss. Apropos to this article, will be the use of non-grantor trusts to salvage much or all this deduction. While the media has focused on bunching itemized deductions and using donor advised funds ("DAFs") to circumvent the impact of the doubled standard deduction, that hardly seems feasible for most taxpayers. With the significant restrictions or elimination of so many itemized deductions bunching, even using a DAF to bunch charity, is unlikely to push many taxpayers over the new standard deduction threshold, and even if that threshold can be exceeded every 2nd or 3rd year of bunching, the donations made up to that level will still be lost.

Example: Client has $10,000 of SALT deductions and donates $5,000/year to charity. If they bunch donations to every third year they will have a $25,000 deduction in that year ($10,000 SALT + 3 x $5,000). But that would only provide a net incremental deduction of $1,000. So, while no doubt some taxpayers will benefit from bunching, the utility seems overstated.

For both lower and moderate wealth taxpayers emphasizing non-tax benefits, using IRA funds for those over 70 ½, donating appreciate assets (and avoiding tax on the appreciation), may be beneficial charitable planning strategies.

For moderate wealth clients, creating a simple local non-grantor trust with a non-compensated family member trustee, may serve to salvage all of a contribution deduction. When crafting these trusts practitioners should be certain to include language in the instrument so that distributions to charity will be made from gross income.[36] These moderate wealth taxpayers can then gift enough

[35] https://www.councilofnonprofits.org/sites/default/files/documents/tax-bill-summary-chart.pdf .
[36] IRC Sec. 642(c).

investment assets to generate sufficient income to pay intended contributions. The trust instrument can name heirs as well as charities as beneficiaries and grant the trustee a flexible distribution power to allocate among charitable and non-charitable beneficiaries. This approach will facilitate moderate wealth taxpayers donating to charities and securing the equivalent of a full income tax deduction, or when they desire instead having heirs in a given year receive some portion or all the income, so that there is flexibility to the planning, even with using an irrevocable trust as the vehicle. For UHNW taxpayers more robust and complex non-grantor trusts achieving a range of goals may be used to also fund charitable gifts along similar lines. However, many UHNW clients already give donations that are substantially more than the standard deduction as increased that the impact on them may be insignificant.

Create A Non-Grantor Trust in Trust Friendly State to Save State Income Taxes

State income taxation on non-source, e.g. passive assets, may be deferred or avoided through the use of non-grantor trusts. This type of planning may be more common for two reasons. First, the SALT limitations make the net cost of state income taxes much higher than before the Act. Therefore, many taxpayers, especially those in high tax states, may wish to pursue this type of planning. Further, given the number of other tax savings opportunities from using non-grantor trusts, taxpayers may already be creating non-grantor trusts for other purposes after the Act.

Practitioners should evaluate whether existing trusts paying high state income tax be modified or moved so that the state income tax can be avoided. An existing trust may be able to be moved to a new state that has a more favorable tax system. That may require moving assets out of the initial state, changing trustees to out-of-state trustees, and assuring no initial state source income. If source income cannot be avoided it may be feasible to divide the existing trust using powers in the instrument, decanting or non-judicial modification, so that one resulting trust has solely non-source income and the other resulting trust earns all source income. Only the former trust would be moved. This type of planning can raise complex issues. What is source income? If the trust owns a partnership interest that has a modest amount of source income to the initial state that might suffice to taint the entirety of the trust as source income. In moving trustees out of state what of an investment advisor or trust protector in the initial jurisdiction? Will that taint the trust as still subject to taxation in the initial state? If so, would creating a limited liability company ("LLC") or other entity in the new jurisdiction to house the protector, investment adviser and other positions so that it is that entity and not the individual resident in the initial state that serves? Will that suffice to break the tie to the initial jurisdiction?

New non-grantor trusts might be created by transferring passive assets, e.g. portfolio assets, to a non-grantor trust in a trust friendly jurisdiction that would not impose any state income tax.

Use Non-Grantor Trust to Save Net Investment Income Tax ("NIIT")

It may be feasible to use non-grantor trusts to save net investment income tax ("NIIT").[37] If the trustee is actively involved in the business held in a non-grantor trust the NIIT tax may not apply whereas had the client held that interest individually it would have had he or she not actively

[37] IRC Sec. 1411.

participated in the business. Remember that the determination of what is required for a trust to actively participate to avoid the NIIT tax remains uncertain. The IRS rulings on this matter have been rather harsh.[38] Several court cases, however, have taken a positive view of a trustee's participation as characterizing a trust as active.[39] That if the trust involved is a directed trust and the general trustee is an institution that is not involved in management, but the investment adviser (or investment trustee) is actively involved? Does that suffice to characterize the trust as active to negate application of the NIIT? Another NIIT planning idea post-Act is to distribute to a child beneficiary who would still have his or her own $200,000 MAGI bucket before a NIIT was incurred.

Schedule Annual Trust Meetings: Proper Trust Operation Vital to Achieving Intended Income Tax Status

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. What if a loan is made to the settlor and the interest rate or security is inadequate? 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 implies agreement to benefit the grantor thereby undermining non-grantor status? 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 SEC v. Wyly case continues to serve as a reminder about the importance of proper trust operation.[40] In Wyly the trust had trust protectors for each of 17 inter-vivos trusts. None of the persons serving as trust protectors were related or subordinate. Nonetheless the trustees followed all investment recommendations made by the protectors including collectibles, etc. The conduct of the trust protectors and settlors was such that the Court imputed all actions of the trust protectors to the settlors since there was a pattern of action. While the Wyly case might be a bit extreme, the concept of a pattern of conduct is problematic in so many situations (e.g., a pattern of distributions from a trust that is then attacked in later divorce). Clients so often do not understand the need to meet annually with legal counsel to identify inadvisable patterns of payments, investments, etc.

[38] TAM 200733023, and TAM 201317010.

[39] Mattie K. Carter Trust v. US, 256 F. Supp. 2d 536 (N.D. Tex. 2003); Frank Aragona Trust v. Comr., 142 T.C. No. 9 (Mar. 24, 2014). IRC Sec. 642(h).

[40] SEC v. Wyly et al, No. 1:2010cv05760 - Document 622 (S.D.N.Y. 2015).

Converting/Toggling from Grantor to Non-Grantor 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. 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.[41] 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.[42]

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.

Example: Client engaged in note sale transaction with a grantor trust several years ago. The client sold a highly appreciated interest in a family business to a grantor trust for a note. Post-Act the client believes non-grantor trust status would provide additional state income tax savings and Section 199A deductions and converts the formerly grantor trust into a non-grantor trust. That may trigger the gain on the conversion that had been avoided on the initial sale to the grantor trust.

If the individual income tax changes sunset in 2026 and could be modified by future legislation, is the cost of complex planning to endeavor to capture current but potentially temporary income tax benefits worthwhile? In many cases it might be. But practitioners might also contemplate possible sunset in planning documents, e.g. by empowering a trust protector or other person to turn on or off grantor trust status (e.g. convert a non-grantor trust into a grantor trust if the intended income tax benefits sunset). The IRS had held against toggling on and off grantor trust status, but the circumstances of that ruling were abusive and the same rationale may not apply to other situations, especially if the toggle is a result of a change in the law (e.g. sunsetting of Act changes).[43] Incorporating a decanting power to facilitate the trustee converting the trust status via decanting might also be worth incorporating. How effective will state efforts be to circumvent

[41] PLR 200848017, CCA 200923024 cf. I.R.S. Notice 2007-73, 2007-36 I.R.B. 545.
[42] IRC Sec. 642(h).
[43] I.R.S. Notice 2007-73

SALT limitations? Does this obviate the need to plan or should planning be pursued as it may provide tax savings with greater certainty? At the time of this writing the outcome of these efforts is uncertain, there are certainly practitioners who are skeptical as to the efficacy of that planning.

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?

Non-Grantor Trusts with Spousal Access Without Tainting Non-Grantor Status

A common planning technique for many years, and especially beginning in 2012 when taxpayers sought to use exemption before it purportedly would decline from $5 million to $1 million was the use of non-reciprocal spousal lifetime access trusts ("SLATs"). In this technique each spouse would create a trust for the other spouse and descendants. The trusts would be crafted to have sufficient differences so that neither the IRS or hopefully a creditor could "uncross" the trusts and undermine the planning. The benefit of the SLAT technique is that a couple could use exemption and retain access to assets transferred, all while achieving asset protection goals. Planning in the current environment has important similarities and differences from the SLAT planning of 2012. These can be used to highlight how planning might optimally be structured now.

- Like 2012 current wealth transfers should seek to secure the high estate tax exemptions before they are reduced by half in 2026 (or by legislation prior to that if there is a change in administration in Washington).
- Like 2012, but even more pronounced, is the need for most taxpayers using current exemption to have access to the assets transferred. The reason access is more important is obvious, the exemptions are larger, and a higher percentage of a client's wealth can be transferred.
- Unlike 2012 SLATs in the current environment should in many, but certainly not all, instances be structured as non-grantor trusts to garner potentially a number of different tax benefits (even considering the 199A Proposed Regulations.

Threading the tax and trust "needle" to meet the above requirements requires a different type of trust, and different planning and drafting then has been historically common. Just as with the completed gift ING suggested above, a new variant of a spousal trust will be necessary to achieve the disparate goals above. This new variant has been referred to as a "SALTy-SLAT" by virtue of the non-grantor SLAT being able to facilitate planning to salvage some of the state and local tax ("SALT") deductions. Others have referred to it as a Spousal Lifetime Access Non-Grantor Trust ("SLANT"). Whether a new acronym is used, drafting non-grantor, completed gift, trusts that are accessible, is a technique to consider for some clients in the current environment.

If the trust is properly structured (no grantor powers to the settlor spouse) and the beneficiary spouse can only receive distributions with the consent of an adverse party, the trust may achieve all objectives: completed gift to use exemption, non-grantor trust for any or all of the planning benefits of non-grantor trust in the post-TCJA environment, and access.

Don't Dismiss Using Non-Grantor Trusts to Enhance 199A

An important focus of the final corrected 199A Regs, is eliminating what the IRS perceived as abuses practitioners had discussed with the use of multiple non-grantor trusts to secure 199A deductions when the taxpayer herself may not have qualified. "*Part I of subchapter J provides rules related to the taxation of estates, trusts, and beneficiaries. For various subparts of part I of subchapter J, sections 643(a), 643(b), and 643(c) define the terms distributable net income (DNI), income, and beneficiary, respectively. Sections 643(d) through 643(i) (other than section 643(f)) provide additional rules. Section 643(f) grants the Secretary authority to treat two or more trusts as a single trust for purposes of subchapter J if (1) the trusts have substantially the same grantors and substantially the same primary beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1 of the Code. Section 643(f) further provides that, for these purposes, spouses are treated as a single person*."

The Final Regulations attempt to quash the ability to use non-grantor trusts to circumvent the Section 199A threshold limitation and take a harsher view then the Proposed Regulations had. "*The final regulations clarify that the anti-abuse rule is designed to thwart the creation of even one single trust with a principal purpose of avoiding, or using more than one, threshold amount. If such trust creation violates the rule, the trust will be aggregated with the grantor or other trusts from which it was funded for purposes of determining the threshold amount for calculating the deduction under section 199A*." The Final Regs take a more stringent view of trusts used to circumvent the taxable income threshold under 199A so that even a single trust can be disregarded if it is created or funded to avoid the rule. For practitioners that created a non-grantor trust for this purpose, it should be evaluated to determine the impact.

The Final Regulations eliminate examples and discussions that the Proposed Regulations had contained concerning the use of multiple trusts to plan around the taxable income threshold for Section 199A purposes. The Final Regulations have deferred back to the statute, Code Sec. 643(f) on multiple trusts. "…the Treasury Department and the IRS have removed the definition of "principal purpose" and the examples illustrating this rule that had been included in the proposed regulations, and are taking under advisement whether and how these questions should be addressed in future guidance. This includes questions of whether certain terms such as "principal purpose" and "substantially identical grantors and beneficiaries" should be defined or their meaning clarified in regulations or other guidance, along with providing illustrating examples for each of these terms. Nevertheless, the position of the Treasury Department and the IRS remains that the determination of whether an arrangement involving multiple trusts is subject to treatment under section 643(f) may be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 643(f), in the case of any arrangement involving multiple trusts entered into or modified before the effective date of these final regulations." The examples that raised concerns and the principal purpose test from the Proposed Regs have been eliminated in the Final Regs but practitioners have little more to rely on with respect to how multiple trusts will be treated other than the bare language of Code Sec. 643(f).

New Spin on The Beneficiary Defective Irrevocable Trust ("BDIT") May Save State Income Taxes

Might a variation of the Beneficiary Defective Trust ("BDT") be used to achieve new planning goals to address the SALT restrictions of the Act? A BDT is an irrevocable trust that is a grantor for trust for income tax purposes as to the beneficiary and not as to the settlor. For example, parent may set up a trust for child, and that trust could be crafted to exclude provisions that would make the trust grantor as to the settlor. The trust would include an annual demand or Crummey power making the trust grantor as to the child/beneficiary.

In the traditional BDT (BDIT) the parent may create a BDT for a wealthy child with a $5,000 initial gift, which would be subject to the child's power of withdrawal which would lapse without gift or estate tax consequences but would remain a grantor trust as to the child so that he or she could sell assets to the trust without triggering capital gain. A good plan, but how can this be spun for the Act?

If the parent lives in a high tax state and the child in a no tax state, might a variation of the typical BDIT approach be used by the parent to shift income to a lower SALT environment to save SALT when they are no longer deductible?

Example: Mom gifts $5,000 to a BDIT that is grantor to son in a low tax state. Mom then directs business opportunity to the trust which has no discernable gift tax value. The income generated will be reported by son in the no tax state. The value of the business opportunity would be grown outside the parent and child's estate in contemplation of the sunset of the estate tax repeal.

Not Every Trust Should be a Non-Grantor Trust

Given the enhanced benefits of using non-grantor trusts post-Act, articles and webinars have extolled the new benefits of using non-grantor trusts. But a broader and more balanced view of the decision process as to whether a grantor or non-grantor trust should be used is necessary. Not every trust should 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 consisting, depending on each particular client's circumstances, of a combination of grantor and non-grantor trusts and perhaps new types of trusts designed to meet current planning objectives.

Prior to the Act, most irrevocable trusts were structured as "grantor" trusts for income tax purposes. With a grantor trust the settlor bears the income tax cost of the income earned by the trust. This so-called grantor trust "tax burn" (of the settlor paying income taxes on income earned by and retained in the trust) further reduces the size of the settlor's estate. The settlor could retain the power to swap or substitute trust assets for personal assets and use it to shift appreciated assets from the trust into his or her estate to gain a basis step up on death. Appreciated assets could be sold to the trust to lock in discounts and shift future appreciation outside the estate without triggering capital gains.

For some clients the continued use of grantor trusts will remain optimal, at least for some of their planning. Existing trusts to which note sales were made of appreciated assets may not be able to

convert to non-grantor trusts without triggering tax costs. For very high net worth clients the ability to sell assets to a grantor trust might justify retaining or creating a grantor trust.

If a trust owns S corporation stock, forming a non-grantor trust (or the 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. It may be preferable for the donee trust to be characterized as a grantor trust rather than meeting QSST or ESBT requirements.

Will the client accept the steps necessary to make a trust a non-grantor trust? For a non-grantor SLAT (a so called "SALTy-SLAT"), is the client comfortable having a child/beneficiary as an adverse party approve distributions? While some will, many will not. Even if the client is agreeable, will designating a child remainder beneficiary to hold an approval power over distributions to the settlor's spouse 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.[44] 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 then 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 of an implied agreement between the power holder and settlor (or spouse).

Is an incomplete gift non-grantor ("ING") structure a safer approach to addressing the need for an adverse party as contrasted with the non-grantor SLAT approach of perhaps naming one diverse party? The answer is not clear. Also, given the approach taken in the proposed Section 643(f) multiple trust regulations, will the IRS continue to issue ING private rulings if it is concerned about the abuse of non-grantor trusts post-Act? Will the complexity of making the transfer to an ING trust a completed gift to use temporary exemption outweigh the advantages? Will the ING characteristic of a distribution committee (aka power of appointment committee), discussed below, add too much cost, complexity or administrative burden for some clients to accept?

Consider the Sanders tax bill proposal. Perhaps it may be more advantageous to structure a grantor trust that might still be grandfathered and exempted from future harsh legislative changes.

Consider Structuring a Community Property Trust for Basis Step-up on First Death

Practitioners might give consideration to planning to USE community property rules to obtain a full basis step up on the death of the first spouse to die (subject to the normal exceptions, such as for income respect of a decedent). While there are 11 states with community property laws, three OF THE states provide elective community property laws that anyone can avail themselves of: Alaska (need to be residents of Alaska, Tennessee and South Dakota). Residents of non-

[44] Treas. Reg. Sec. 1.672(a)-1(a).

community property states, for example, can create a community property trust in Alaska and obtain a full basis step up on the first spouse's death on all assets held in that community property trust. In reality, it is not a step up but more akin to a mark to market regime as basis can be stepped down as well. That can be valuable for many client situations and thereafter estate tax minimization planning might proceed without being hindered by low basis issues on those assets. For example, if a highly appreciated rental property or business interest were transferred to an Alaska community property trust by a domiciliary of a non-community property state, e.g. New York, on the death of the first spouse the entirety of that asset would benefit from a basis step-up. Thereafter, one-half of the assets, with a basis equal to fair value, would be distributed as would the estate of the first spouse die, and one-half to the surviving spouse. For a non-resident of Alaska to create an Alaska community property trust as in the above illustration a requirement to benefit from the Alaskan law is to name a qualified trustee AS AN administrative trustee, e.g. an Alaskan trust company.

Consider Planning in Light of Possible Democratic Estate Tax Changes

Senator Bernie Sanders' proposed tax act entitled "For the 99.8 Percent Act" might be what could occur if the so-called Blue Wave (that is, the Democrats winning both Houses of Congress and the White House) from the 2018 mid-term elections continues through the 2020 election. Practitioners should caution clients that it might be advisable to implement planning in advance of the election.[45]

Consider Downstream Planning (not Upstream) for UNHW Clients

A valuable "asset" of many UHNW families is the unused exemption of their children. But in many cases children of even UHNW families do not have sufficient resources to make gifts to use their exemptions. If the parents endeavor to loan funds to the child so that the child can make gifts to use exemption those loans may be recharacterized as a gifts, triggering gift tax on a purported loan recharacterized as a gift. Perhaps an alternative might be for an existing dynasty trust, of which the children are beneficiaries, to guarantee the loan so that it may in fact be characterized as a loan. The child/borrower may then use the funds to consummate a gift.

Be Wary of Risks of Upstream Planning

Upstream planning, to shift values to a higher generation family member not subject to the estate tax has been discussed by a number of commentators. This type of planning has been given considerable attention in light of the current large temporary exemptions. Clients have a net worth substantially in excess of the approximately $22 million per couple exemption, might consider upstream planning if, for example, the client's parents have a net worth combined of well under the current exemption, e.g. only $2 million.

[45] Portions based on: Shenkman, Tietz and Blattmachr, "The Bernie Sanders Estate Tax Proposal - Might it Foreshadow Future Democratic Proposals?," Estate Planning Newsletter #2715 (April 4, 2019).

Upstream planning might be effected by the clients creating a GRAT that is calculated to vest in each parent somewhat less than the maximum amount which, when added to their other assets, would not exceed each parent's estate tax exemption at the time that each parent dies. The parents can revise their estate planning documents to bequeath the remainder interest to a trust for the benefit of the client and the client's descendants. This transfer might not only absorb the parent's estate tax exemption but might utilize each parent's GST exemption (because there is no ETIP with respect to the parent as beneficiary of the upstream GRAT). The IRS might have no objection to this planning because it actually uses exemption, rather than being an assignment on day one (or two) of a nominally valued remainder interest.

Another approach to upstream planning is to create an irrevocable trust with a general power of appointment ("GPOA") to a person living in a non-decoupled state who has a modest estate of her own. The presence of that GPOA should cause estate inclusion of trust assets in that person's estate generating no estate tax but an adjustment of basis on her death.[46] This type of GPOA planning raises a host of questions to consider.

How can protection before afforded against an unintended or undesirable exercise of the GPOA granted? For example, the exercise of the GPOA could be conditioned upon the consent of a non-adverse party providing a measure of protection. Instead of a GPOA, a limited power of appointment ("LPOA") could be provided to that intended person, and another person can be given the power, in a non-fiduciary capacity, to convert the LPOA into a GPOA before the powerholder's death. If the trust is formed in a jurisdiction that permits silent trusts, is there a need to even inform the power holder of the existence of the GPOA? The scope of the GPOA could be limited. For example, the power holder may only be granted the right to appoint to the creditors of her estate and to the descendants of the grantor of the power or trusts for their benefit.

This type of upstream GPOA planning might raise creditor issues. Confirm that the existence and exercise of the GPOA will not subject the trust assets to the claims of the creditors of the powerholder. If that is a risk, might conditioning the exercise of the power on the powerholder being solvent limit such risk? A GPOA may also subject the assets to a parent's or other power holder's Medicaid claim for reimbursement.[47]

But although many practitioners have touted the use of "upstream" planning to salvage otherwise unusable exemptions that elderly relatives of clients have, the planning is not assuredly beneficial. Consider the consequences of upstream planning if there is a Democratic victory in 2020 a proposal like Sanders is enacted. For example, if a parent has an estate of only $4 million, child could create a trust with $7 million, and give parent a general power of appointment ("GPOA") over that trust. The intent of the plan was that parent's estate would include the assets in the trust and those assets would garner an estate tax free adjustment (hopefully step-up) in income tax basis on parent's death. If the exemption is reduced to the $3.5 million as in the Sanders Act, the plan too garner a basis step-up at no tax cost may trigger a substantial estate tax cost that was unintended.

[46] IRC Sec. 2041.

[47] Acknowledgement to Bernard Krooks, Esq. for this caution.

Practitioners should carefully review any upstream planning that may have been implemented to endeavor to avoid this result. For example, the elderly parent could be granted a limited power of appointment and someone given the right to convert that to a general power of appointment. If the exemption is reduced the conversion would not be triggered. While many such upstream plans were likely crafted to only include in the senior generation's estate an amount that does not trigger an estate tax, the more prudent course of action would be to confirm that. Clients who only recently had planning updated to address the inclusion of GPOAs to a higher generation will likely be frustrated by the yo-yo tax law changes and ongoing planning updates.

Credit Shelter Basis Planning Risk

Practitioners have been helping advise and guide clients on terminating credit shelter trusts, or distributing appreciated assets out of a credit shelter trust to garner a basis step up on the death of the surviving spouse. If a Sanders type bill is enacted after the 2020 election that could prove a costly mistake. While terminating or distributing assets out of a credit shelter trust to gain a basis step up might be advantageous with an $11.4 million exemption it could prove to be a very costly gambit if the surviving spouse dies after the exemption drops.

Maximize GST Tax Planning Before Potential Changes

Another foundation of planning has been to shift value to an irrevocable trust and allocate generation skipping transfer ("GST") tax exemption to the trust. Properly done under the current system, the value of assets in that GST exempt trust, no matter how much they appreciate, should never be subject to the transfer taxation system. The compounding of wealth outside the estate tax system can provide incredible wealth shifting opportunities. When this is coupled with a long-term trust (dynastic trust) wealth can compound outside a client's estate forever. The Sanders proposal appears to limit the application of the GST exemption to a maximum of 50 years. That change would hinder this type of planning and might result in a costly tax after 50 years of a trust's existence. If a change along the same lines as this proposal is enacted, but if it "grandfather's" existing trusts (i.e., the new restrictions only apply to trusts formed after the new law), many people, even those of moderate wealth, might benefit from creating long-term dynastic trusts now.

Grantor Retained Annuity Trusts ("GRATs")

A key benefit of GRATs is that clients can create these trusts to shift wealth out of their estates without using any (or any material) part of their gift tax exemption, to the extent the assets in the trust grow at a rate above the so-called Section 7520 rate (a relatively low rate the IRS announces each month). Many, perhaps most, GRATs were structured by practitioners as so-called zeroed out GRATs. This meant that the annuity payment the trust made to a client as the grantor creating the trust equaled (or almost equaled) the value of assets gifted to the trust. Upside appreciation (above the rate of return the IRS required be used in the technique) would inure to the beneficiaries of the GRAT with no gift tax cost. The Sanders' proposal would perhaps eliminate the viability of this technique in many cases by requiring a minimum 10 year term for any GRATs created after the enactment. If a client does not outlive the term of the

GRAT, some or all the assets (generally) are included in the client's estate. That would dramatically increase the risk of a GRAT succeeding. There is also a minimum required gift amount, effectively removing the ability to have a zeroed out GRAT. These two changes could potentially make GRATs impractical for very wealthy taxpayers that have traditionally used GRATs when they no longer had gift tax exemption remaining. It would also seem to eliminate the commonly used technique of "rolling-GRATs", where practitioners would create a 2 year GRAT and the client would "re-GRAT" each annuity received to a new GRAT and continue to shift appreciation beyond the Sec. 7520 rate out of the estate taxation system. Practitioners should consider this if planning to use GRATs now. If rolling those GRATs is eliminated in but a few years the plan may not work as anticipated.

Crummey Powers, Powers of Attorney and Insurance Trusts

Another common planning tool has been for clients to make gifts to trusts from which a class of beneficiaries can withdraw a pro-rata portion of the gift made by the grantor, up to the annual gift exclusion amount for that beneficiary. This has facilitated the ability for clients to make large gifts to a trust, e.g. used to buy and hold life insurance, and not incurring any gift tax cost due to the gift. The Sanders proposal has proposed eliminating this technique by restricting annual gifts to $10,000 per donee and a maximum of $20,000 per donor. If this applied to all trusts after enactment, the results could eliminate the common Irrevocable Life Insurance Trust ("ILIT") which has been ubiquitous in estate plans. Practitioners might discuss with their clients implementing an ILIT so it is in place before any changes are made to existing law, in case existing trusts are grandfathered (i.e., exempted from the new change). Clients might also consider making large gifts now (using that exemption that might also disappear) so that they won't have to rely on annual gifts to fund their life insurance premium payments.

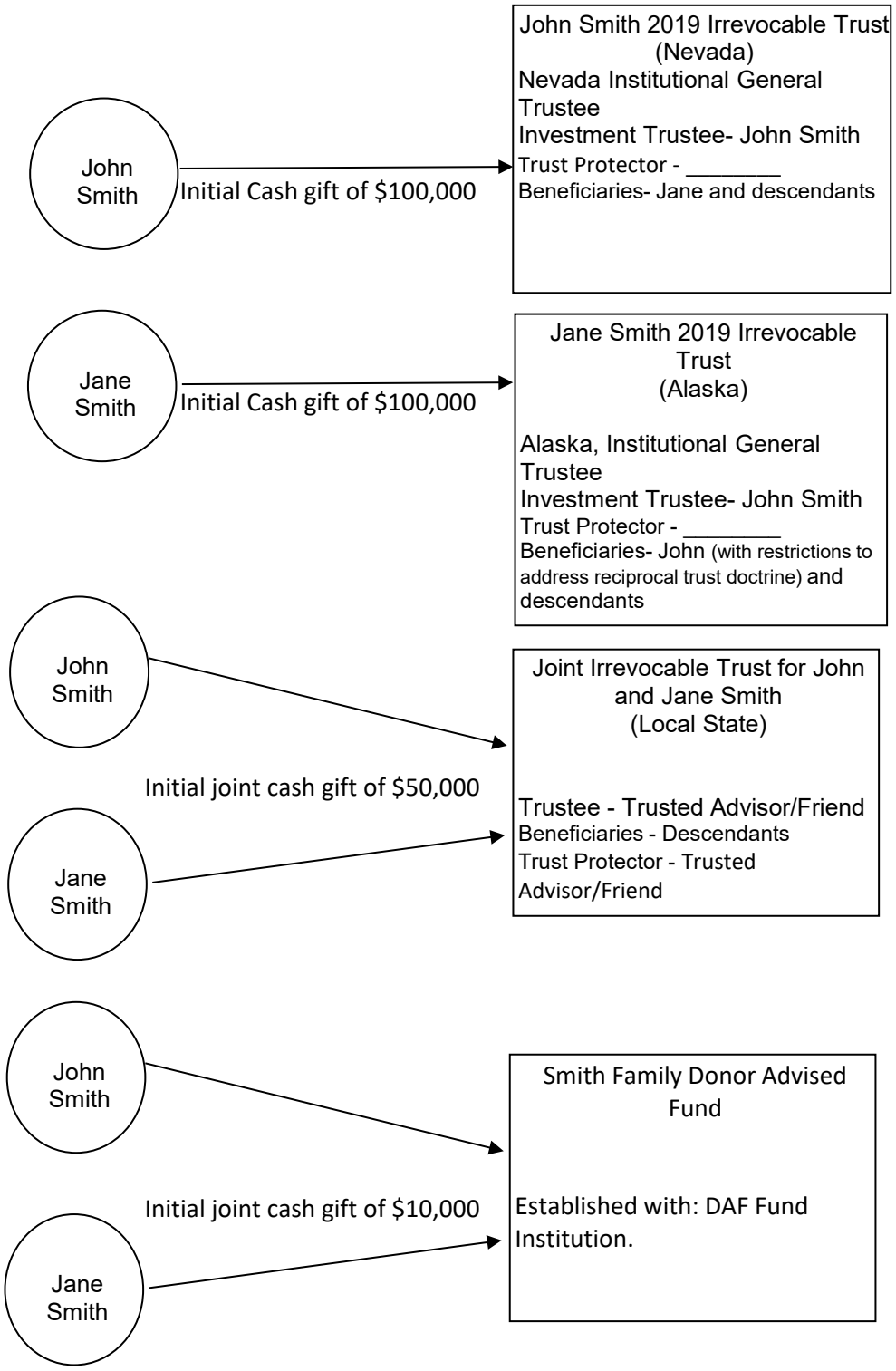
Example: Client has a typical ILIT with Crummey powers. Premiums are $75,000/year and are easily covered by the annual demand powers available to children and grandchildren who are beneficiaries of the trust. But if a Sanders' type law is enacted and Crummey powers prospectively eliminated (even for trusts predating the law change) the client will not be able to fund premiums without incurring a costly current gift tax cost. The client might be able to transfer a sufficient amount of marketable securities to the trust now, using her exemption, so that the future premiums can be paid from a combination of the income and principal of the gift made. It might also be worthwhile if this is pursued to inquiring as to the results of prepaying future premiums currently to minimize future income tax costs to the client.

Example: Since GRATs are also on the chopping block, a wealthier client who does not have adequate exemption remaining to complete a large gift as in the prior example, might create and fund a GRAT that pours into the ILIT (a common approach when exemptions were lower for a non-GST exempt ILIT). The GRAT could be planned to endeavor to shift value to the ILIT to avoid the gift tax issues because if Crummey powers are in fact eliminated. This type of GRAT/ILIT plan might also be structured different then such plans had been historically. The traditional GRAT/ILIT plan would have entailed creating a two year GRAT with the ILIT as the beneficiary. Each time an annuity payment was made the client would re-GRAT the annuity into a new GRAT also benefiting the ILIT. But if GRATs are slated for restriction as in the Sanders' proposal then perhaps a tier of GRATs with different terms might be created now, before the

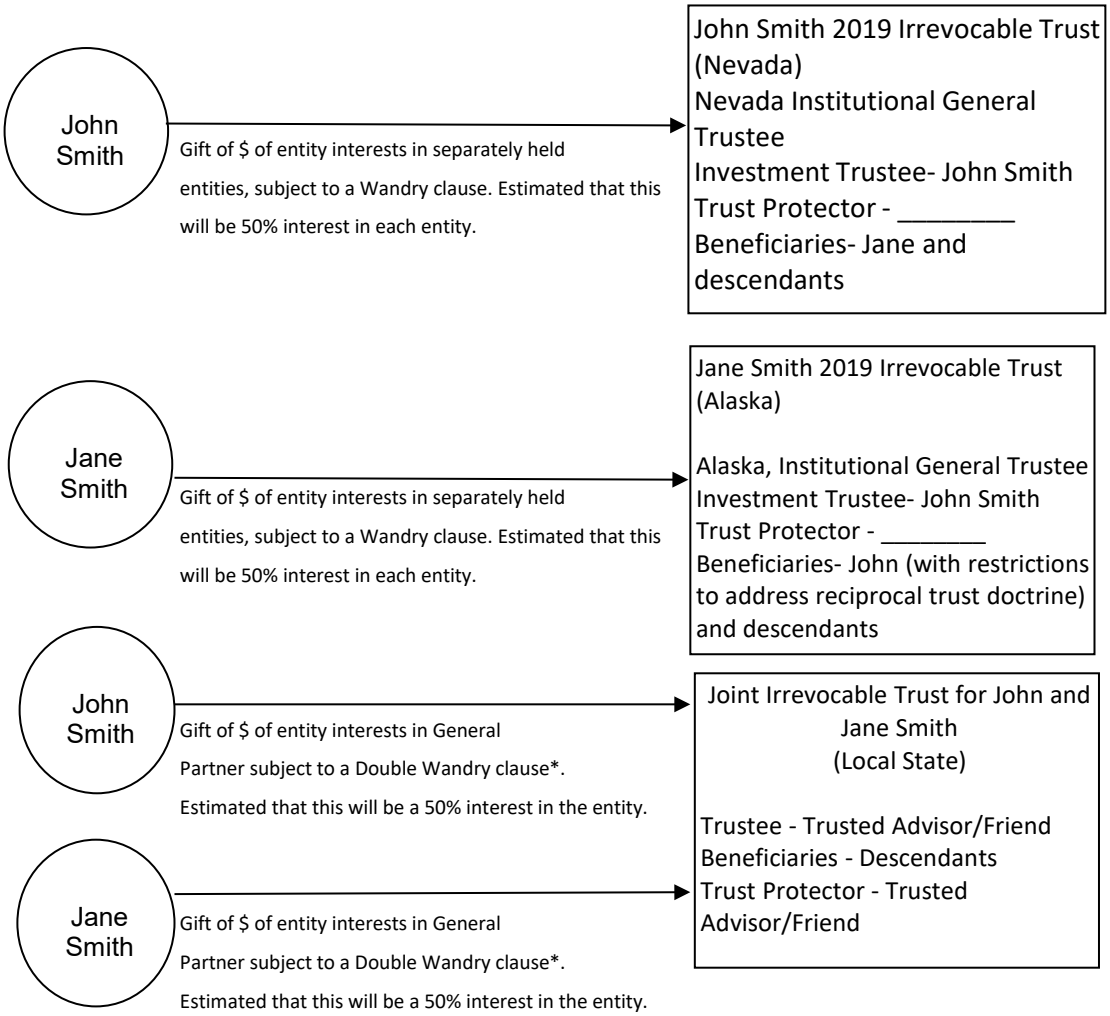
new GRAT restrictions are enacted, so that the existing GRATs may be grandfathered and continue to fund insurance premiums for years to come despite the restriction on Crummey powers.

John and Jane Smith
Estate Planning Schematics

Create Irrevocable Trusts and DAF

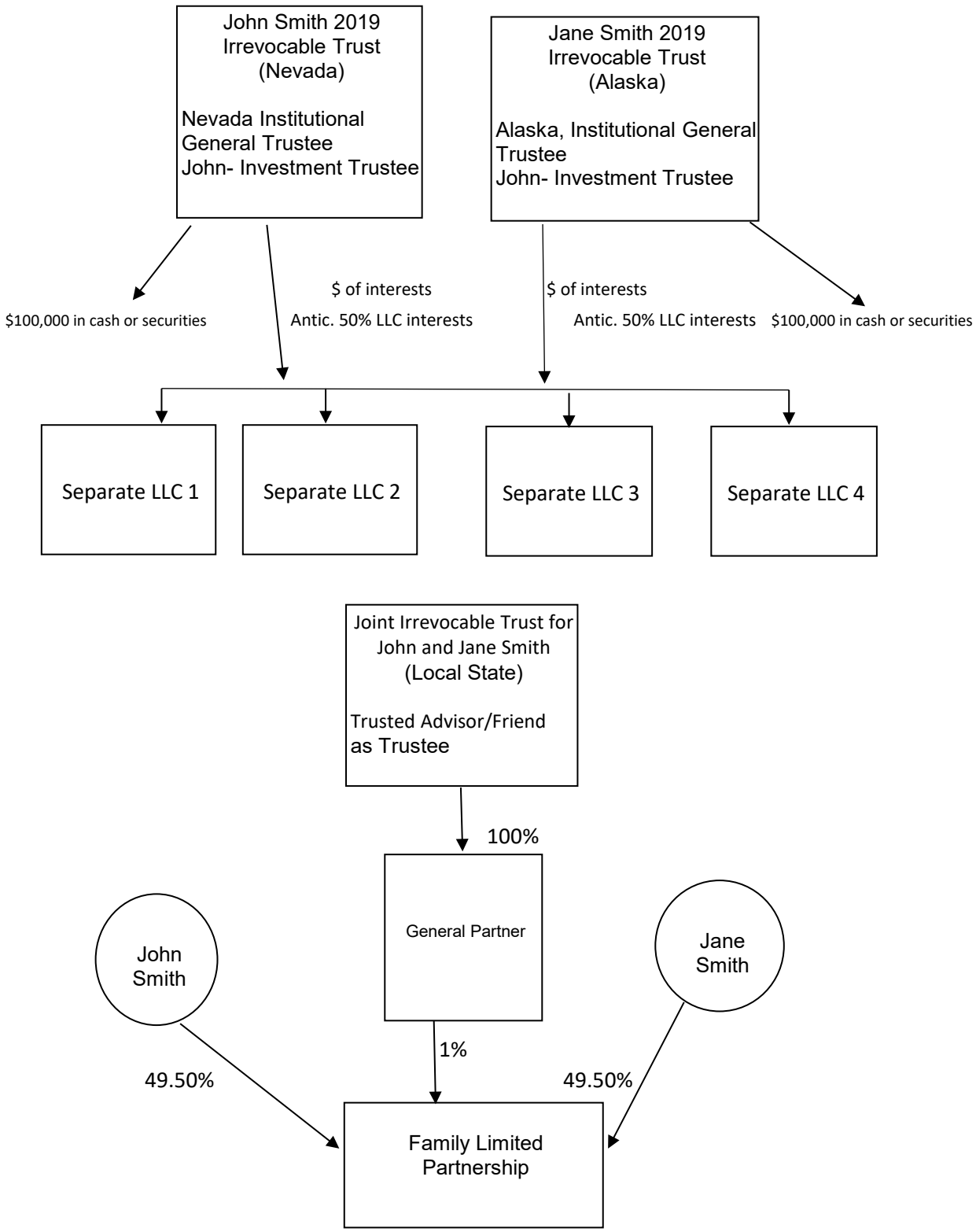


Gifts to Irrevocable Trusts- July 2019

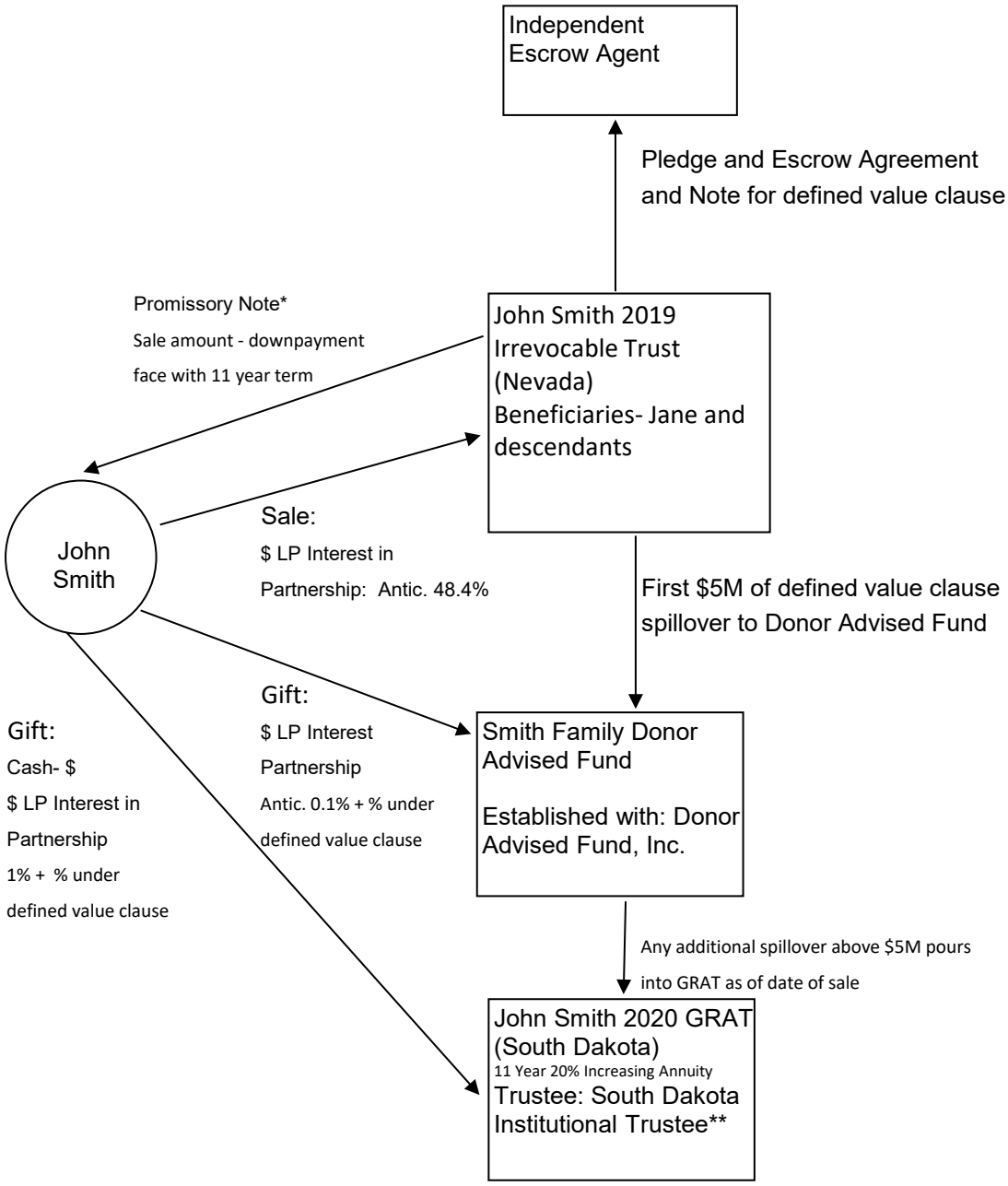


*Any interests remaining in name of donor after application of traditional Wandry clause are sold as of the same date at gift tax value as finally determined to avoid retetion of interestes to possibly deflect Powell attack.

Ownership after Gifts



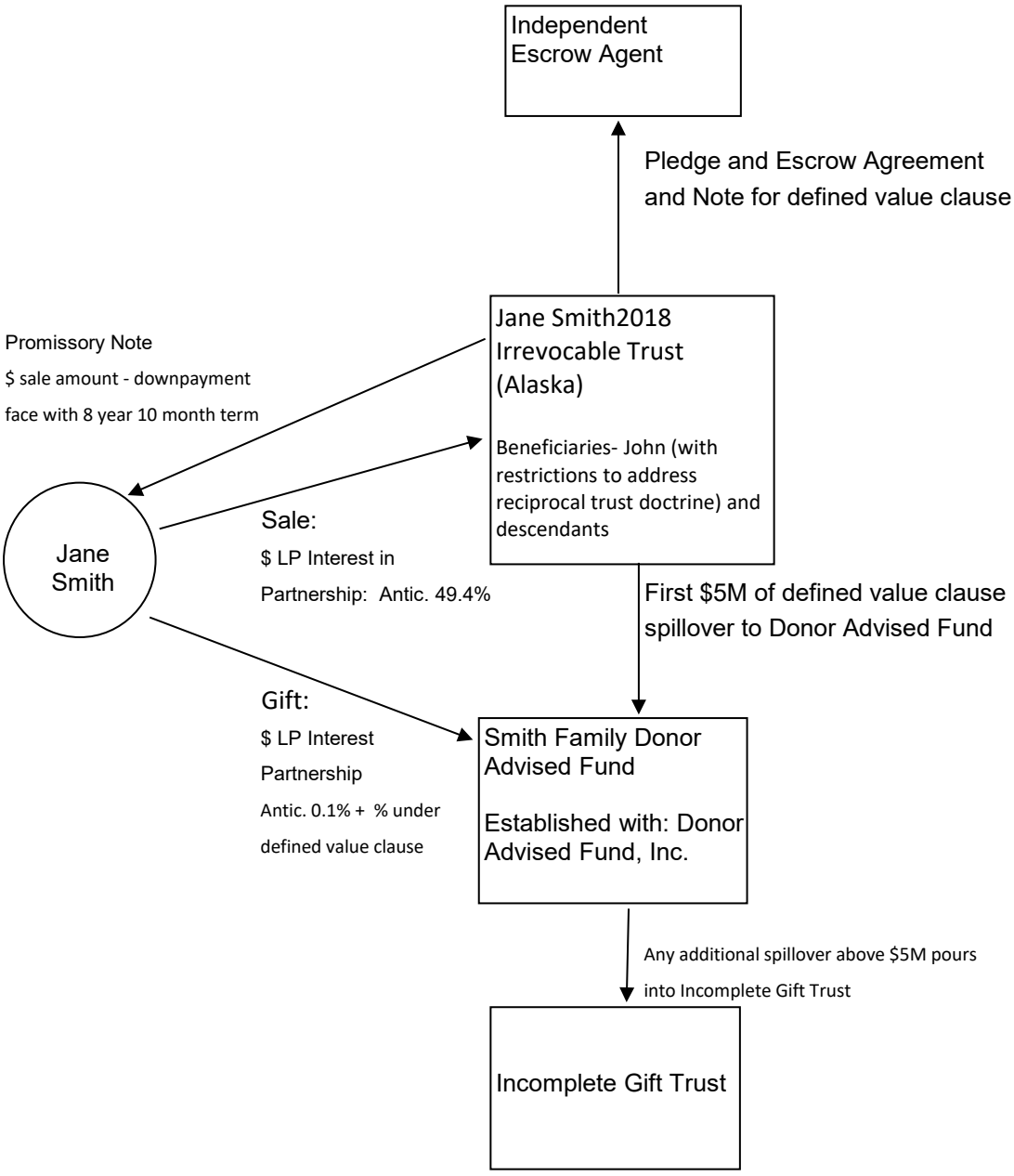
Sale by John Smith of LP interests in Partnership January 2020



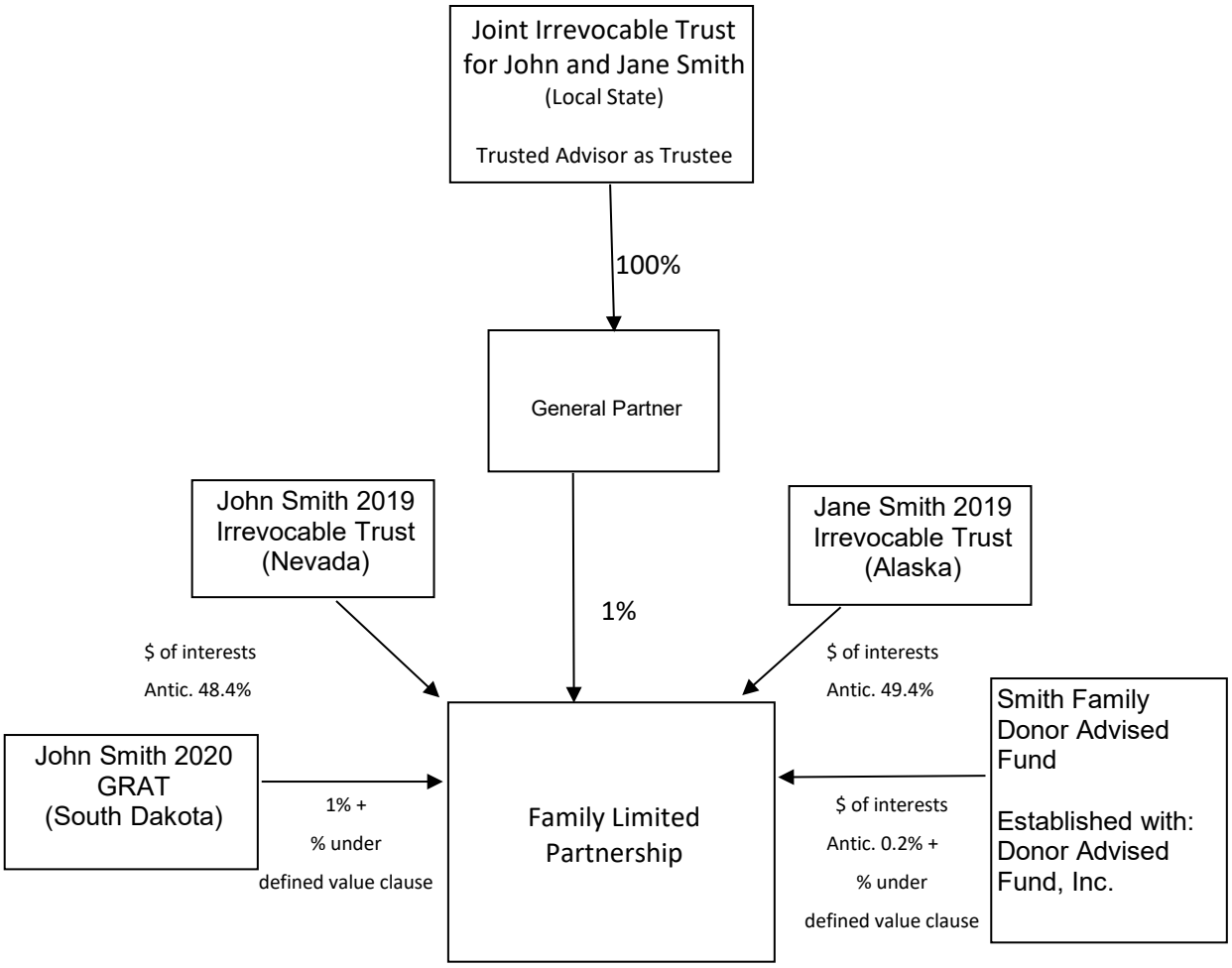
*The promissory note will have a stepped-up interest payment with defined interest percentages and a prepayment penalty.

**Consider: Can you graft an incomplete gift trust onto the GRAT defined value mechanism under the transaction without a Proctor challenge?

Sale by Jane Smith of LP interests in Partnership January 2020



Partnership- Trust Ownership after Gift and Sale



Administration matters to address include:

1) Payment of interest under promissory notes.
2) Payment of annuity amounts under GRAT.
3) Ensure that any distributions from Family Limited Partnership are pro-rata.
4) Respect of new ownership structure and role (if any) of clients after selling interests.
5) All entity/trust formalities respected (e.g. Invesment Policy Statements, correct person signing documents, etc.)