Estate Planning Post OBBBA: Basis, Non-Grantor Trusts, and More

Planning Has Changed

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A KEY ESTATE PLANNING GUIDE

LawEasy

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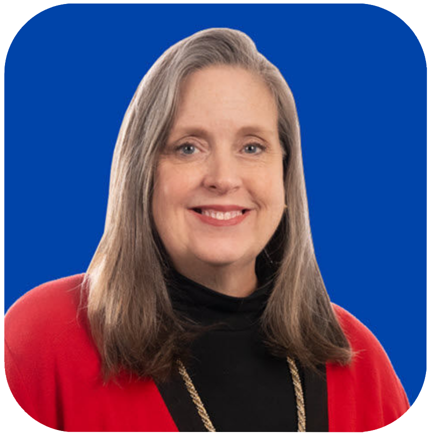

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Post OBBBA
Estate Planning Documents

Talk of “Simple” Documents May be a Mistake

Should Common Trust Planning be Skipped?

- No!
- The estate tax exemption is only permanent until it is changed.
- Outright bequests are not protected from divorce, claimants or future tax changes.
- At minimum consider disclaimer mechanisms into trusts to provide options and flexibility.

Post
OBBBA ILIT Planning

What's Different?

OBBBA Made No Insurance Changes, But….

- When is the last time the ILIT trustee had an analysis done of the policy performance, carrier suitability and appropriateness of the plan?
- For MANY ILITs the insurance was purchased in part or even solely for estate tax purposes. Many perhaps most ILIT trustees should have an independent insurance review and determine the status and appropriateness of the coverage.
- Consider advising beneficiaries that the primary purpose for the policy may have been obviated by OBBBA and what the options are.
- Should the policy, if performing, be continued in case the "permanent" exemption is changed?
- Might the existing policy be converted or exchanged into a policy that better serves the ILIT beneficiary needs?
- Should the policy be sold?

OBBBA Made No Insurance Changes, But….

- Might the policy be swapped or sold the insured and then converted into a policy with long term care features?
- Can the ILIT be decanted (merged) into a SLAT or other trust (perhaps after a late allocation of GST exemption) to simplify planning, funding and administration?

Basis Planning Post-OBBBA

Introduction and Overview

Overview

- OBBBA changes how advisers should look at estate planning. Many clients will no longer face a Federal estate tax with the new $15M permanent exemption. As a result, income tax planning, and in particular maximizing income tax basis, may be a focus of increased attention. In addition to upstream planning with GPOAs, what about downstream planning with gifts? Basis step up planning may conflict with traditional planning of keeping assets in trusts for a surviving spouse and other. What can be done with existing credit shelter trusts, SLATs and other irrevocable trusts that our outside of anyone's estate?   Can and should existing estate tax plans be unraveled? How can powers of appointment be effectively used to increase options for basis step up? Can upstream and as well as downstream planning be used? How id gift planning different then before?

Why is basis planning different Post-OBBBA?

Income Tax Planning A Greater Priority

Why is basis planning different Post-OBBBA?

- Permanent $15 million exemption.
- Other considerations.

Fundamentals of Basis Planning Post-OBBBA

Some Basics and Some Background

Fundamentals of Basis Planning Post-OBBBA

- Why is basis important?
- How is basis determined?
- How is basis changed over time by depreciation, capital improvements, stock dividends, etc.
- Basis in the event of a sale?
- Basis in case of a contribution to a business or trust.
- Basis at death.
  - In general.
  - IRD – income in respect of a decedent.
  - 1014. An overview.
  - Rev. Rul. 2023-2.

Ancillary Considerations for any Basis Planning

Plan Holistically

Ancillary Considerations for any Basis Planning

- Don’t be fooled that the exemption will never be lowered by a future administration.
- Consider the potential loss of asset protection benefits of unwinding any irrevocable trust.
  - Medicaid.
  - Other lawsuits.
  - Incapacity.
  - Divorce.
- Consider the liability exposure of all fiduciaries, advisers and others involved in the actions.

Complete Vs. Incomplete Gift Trusts
Grantor Vs. Non-Grantor Trust

Have Your Tax Cake and Eating it Too

Complete Versus Incomplete Gift Trusts

- You can create an incomplete non-grantor trust and have both estate inclusion for step up and a non-grantor trust to garner increased SALT, charitable, 199A and other tax benefits under OBBBA.
- Caution – NY and CA will no longer respect incomplete gift non-grantor trusts so there may be no state income tax savings. Completed gifts trusts may still avoid NY and CA income taxation but then you have to use other tools to gain estate inclusion for basis step up.
- Caution – The IRS will no longer issue PLRs on ING trusts.

More On Incomplete Gift Non-Grantor Trusts

- Settlor retains testamentary and inter-vivos LPOA to cause estate inclusion?
- Other considerations.

Downstream Planning

Gift Tax Was to Backstop the Income Tax But…

Downstream Planning

- Gift assets to an adult child (or trust that is grantor as to that child, e.g. a Sec. 678 Trust) not subject to the Kidde Tax before a sale.
- Parent or senior generation may not be concerned about making gifts that use exemption but most taxpayers won't care. So, if they can shift an asset in advance to adult children not subject to the Kiddie Tax the family may be able to realize income at lower graduated income tax rates and perhaps reduce or avoid state income taxation.
- Avoid the assignment of income doctrine.
- When the asset is sold the child (or a trust that is grantor as to the child) will realize the gain in a lower tax bracket.
- If the amount is small perhaps a simple outright gift will suffice.

Down Stream Options

- For child subject to Kiddie Tax – a non-grantor trust may be preferable since the child will pay tax at the parents' rate and the complex trust may be able to lower income tax.
- Child older so that the Kiddie tax does not apply, a 678 trust that is grantor as to the child, will shift income to the child at the child's lower federal income tax rate and perhaps also with a lower state income tax.

State Law Community Property Trust

Full Basis Step up On First Spouse Death for Non-Community Property Residents

State Law Community Property Trust

- If a couple residing in a non-community property state (with no community property assets) creates a trust in a jurisdiction that has an opt in community property trust statute (AK, TN, SD, and others), they may qualify for a full step up in income tax basis on the first spouse’s death.
- 1014(b)(6).

Joint Estate Step-Up Trust

Is the JEST a Viable Option for Non-Community Property Residents?

JEST - 1

- A joint revocable trust created by a couple in a non community property state which some suggest may permit a step-up in income tax basis of all trust assets upon the first death based on each spouse having a GPOA.
- Is there a deemed gift from one spouse to the other at death? That gift may not qualify for the unlimited estate tax marital deduction.
- Can you have a GPOA over property owned by another person during the period when the trust can be revoked?
- What are creditor protection implications?
- The IRS has indicated that this technique may not work.
- Assume each spouse contributes ½ the property to the JEST. What are the possible tax consequences?
- Each spouse puts in ½ the property and it is a grantor trust as to the property each spouse contributed. When first spouse dies say H dies, then the deceased H gets a GPOA over the entire trust and that is the basis that some argue that all trust assets qualify for a step up in income tax basis. There are several possible issues with this.

JEST - 2

- Do you have a GPOA under Sec. 1041 to cause estate tax inclusion since you did not get the GPOA until you died?
- Does Sec. 1014(e) apply since you can appoint the property back to yourself is that the equivalent of getting the property back triggering the 1 year rule?
- What if you = Wife creates a trust she can revoke and she gives spouse = Husband from inception a GPOA. Does Husband actually have ownership over those assets to cause estate inclusion since wife could revoke the trust at any time. Does this create a conflict between the GPOA and the revocable provision?
- An old indicated that property can be included in the estate of two people. Can that be or is property owned for estate tax purposes by only one person at a time?

Existing SLATs and Other Irrevocable Trusts

Causing Inclusion for Basis Step Up

Existing SLATs and Irrevocable Trusts

- How to get SLAT assets moved into trust in 2012 when we thought the exemption would drop to $1M and now they have say $3M in a SLAT and don't need it.
- Swap or buy assets out.
- Distribute to spouse and other beneficiaries if a discretionary standard permits.
- Revisit old planning. No one that put assets into an irrevocable trust in 2012 anticipating a $1M exemption in 2013 (that did not occur) anticipated a $15 million permanent exemption. Those trusts may provide no estate tax benefit, create administrative costs and hassles, and now not only no estate tax benefit but an income tax benefit from no basis step up. Many clients will appreciate advisers helping them revisit that old planning. What might be done?
- Can you decant to add a LPOA and have that exercised to a trust that facilitates estate inclusion?

Existing Credit Shelter Trusts

Can you Get a Basis Step Up?

Existing Credit Shelter Trusts

- Another, there are 2 million credit shelter trust most of which probably provide no tax benefit.
- How can we get those assets back into an estate for basis step up?

Planning for Basis Post-OBBBA

Recap of Ideas you May Use For Basis Step Up

What Techniques Can you Use To Get a Basis Step Up?

- Many people with family trusts will just gut the trusts.
  - Institutional trustee may not permit but a family trustee may permit.
  - Better to consider a formal agreement.
- Non-Judicial Modification Agreement (NJMAs).
  - What do trust terms provide?
  - What are circumstances of all beneficiaries involved?
  - Creditor protection considerations?

What Techniques Can you Use To Get a Basis Step Up?

- Can it be modified to get both goals of continued asset protection and basis step up.
  - Give the surviving spouse/beneficiary a limited power of appointment to exercise to trigger the Delaware tax trap to cause estate inclusion.
  - Give the surviving spouse/beneficiary a general power of appointment to cause estate inclusion if state law will not then expose those assets to creditors' reach, e.g. AK.
- Decant to add a power of appointment.
- Upstream Planning.
  - Giving a parent or other senior family member with a more modest estate a GPOA.

Post
OBBBA Estate, Trust and Income Tax Planning

Non-Grantor Trusts Should Be in Your Planning Toolkit

Enhance Your NEW Estate Planning and Income Tax Planning Toolkit

- The purpose of this program is to help advisers provide both an estate and income tax planning value to their clients using, when appropriate, non-grantor trusts.
- First we'll illustrate how these can be used for various planning circumstances.
- Then we'll provide background on what a non-grantor trust is and how they work.
- Finally, a deeper dive will be taken into charitable planning post OBBBA using non-grantor trusts and some other techniques.
- Yes, the "new estate plan" may be using trusts to save income taxes more than saving estate taxes (but you can do both)!

OBBBA Non-Grantor Trust Tax Planning Examples

Help Your Clients Avoid Deduction Limitations and Save Taxes

Non-grantor Trust Can Salvage New SALT Deduction

- OBBBA increased the deduction for state and local taxes (SALT) from $10,000 to $40,000.
- Post-OBBBA it may also be advantageous to shift income from a client's personal return to a non-grantor trust to lower the client's income to qualify for various OBBBA income tax benefits.
- **Example** if the client's income exceeds $500,000 the new $40,000 state and local tax deduction (SALT) limit is reduced. When income reaches $600,000 the entire OBBBA SALT deduction increase is lost and only the $10,000 prior amount will be permitted. So, if the client's income is in that phase out range, shifting income producing assets to a non-grantor trust may facilitate obtaining that full SALT deduction.
- Thus, the creation of a non-grantor trust to obtain dollar for dollar income tax deductions at the trust level, while still deducting the larger post-OBBBA standard deduction, may also support several other tax planning benefits.

Non-grantor Trust Can Salvage New SALT Deduction

- **Example** Your client has $2M of non-retirement assets producing $100,000 of annual income. They gift the $2M to a non-grantor trust formed for their spouse and all descendants. This way, their spouse can receive distributions in the future if needed (e.g., in retirement), and they do have to lose all access to the trust income. Obviously, they should avoid distributions to accomplish the tax planning goals. Their income is reduced from $600,000 - $100,000 to $500,000 and they can claim the full $40,000 deduction for state and local taxes.
- The trust income can be used to pay for charitable contributions which is discussed below.
- Trust income can be distributed to children in lower tax brackets.
- The trust may engage in other planning to maximize other tax benefits.
- **Language for adverse party approval**: “No income or corpus shall be paid or appointed to or for the benefit of the Grantor's Spouse without the consent of an adverse party as defined in this Trust.”

QBI and 199A Enhanced By Using Non-Grantor Trusts

- Another post-OBBBA tax planning consideration in monitoring distributions to enhance the tax benefit that may be realized under the Qualified Business Income (QBI) rules. Code Section 199A.
- OBBBA made the Section 199A Qualified Business Income (QBI) deduction permanent and increased the thresholds that apply for specified service, trade, or businesses (as SSTBs). These are professionals like doctors, lawyers, accountants, dentists, etc. OBBBA changed the phase-in range from $100,000 to $150,000 for married taxpayers filing a joint return. That means when your married client's income exceeds $150,000, the 20% QBI deduction starts to phase out.
- **Example**: Here's a plan to illustrate post-OBBBA planning. Say your client is a dentist earning $200,000 a year operating out of an office her practice owns. The dentist can set up 3 non-grantor trusts, one for each child. She can then gift the building (in an LLC) 1/3rd to each trust. The practices leases the use of the building back for $50,000 year (assume that is fair rent). Each trust qualifies for a QBI deduction on the rental income and the dentist also qualifies as her income is below $150,000.

Tip Income

- OBBBA gives a temporary deduction of up to $25,000 for qualified in 2025 through 2028 tax years. The deduction phases out when the taxpayer’s Modified Adjusted Gross Income (“MAGI”) exceeds $300,000 (for a married taxpayer filing a joint return).
- **Example**: Your client is married and earns $350,000. One spouse earns qualified tip income, but part of the $25,000 OBBBA tax break will be lost. They could shift investment assets to a non-grantor trust and push income below the phase out range and qualify for the full $25,000 deduction.

Non-Grantor Trusts May Enhance Tax Benefits Post-OBBBA

Basics of Non-Grantor Trusts

Background on Non-Grantor Trusts

- An important planning tool to help many taxpayers deduct in full their OBBBA tax benefits whether or not they can itemize their deductions, is the use of non-grantor trusts. Moderate wealth taxpayers can use this type of planning as well us ultra-wealthy taxpayers. To understand this type of planning, which may become more common post OBBBA, some basics of non-grantor trusts must be understood.
- Non-grantor trusts are trusts that pay their own tax in general terms. This is quite different than grantor trusts where the trust income is reported on the income tax return of the person who is deemed the grantor for the trust, often the person who created the trust. When calculating the income of a non-grantor trust the rules of how you as an individual taxpayer determine your taxable income are used, except as specifically modified by the trust tax rules.

Background on Non-Grantor Trusts

- DNI - Non-grantor trusts can deduct certain distributions made to trust beneficiaries. That is because, in general, the beneficiaries receiving the distributions report that income on their personal income tax returns.
- To the extent that the trust retains income (i.e., it does not distribute it) that income is subject to trust income tax rates. Trusts face compressed income tax rates. Trust income is taxed at the highest 37% tax bracket in 2025; a trust pays the maximum federal income tax rate of 37% on taxable income over $15,650. In dramatic contrast a married couple filing a joint income tax return in 2025 reaches the maximum federal income tax rate of 37% on taxable income over $751,600 .
- Trust income may also be subject to the net investment income tax of 3.8% (Code Section 1411).

Non-Grantor Trusts Distributions to Spouse and Descendants

- With all these complexities and seeming tax negatives, why use non-grantor trusts? There are, depending on your circumstances, many benefits.
- If you create a non-grantor trust for your spouse and descendants, the trust can distribute income your spouse does not need to your descendants who may be in a lower income tax brackets. Distributions to these beneficiaries carries out trust income to be taxed on their returns (called distributable net income or DNI). The trustee may even poll the beneficiaries each year and determine which are in the lowest overall tax bracket (counting state and federal income taxes) and make distributions to lower your family's overall income tax burden.
- Note, however, that a trust for one's spouse is a grantor trust. However, this result presumably can be avoided by allowing distributions to the spouse only with the consent of an adverse party within the meaning of Code Section 672. One must be cautious to ensure that the distributions the adverse party allows to be made to the spouse are not gifts by the adverse party or fall under the annual exclusion.

More Non-Grantor Trusts Planning Considerations

- Might the trustee loan funds to the beneficiary in the high tax state, thereby avoiding distributable net income (“DNI”) flowing out to that beneficiary (understanding that the trust will have taxable interest by reason of the loan)?
- Will the trustee be willing to make unequal distributions if it overall saves income taxes? If $50,000 is distributed to a beneficiary who resides in a no-income tax state and a loan of $50,000 is made to a beneficiary in a high tax state, will the Internal Revenue Service or a state taxing authority respect the loan or recharacterize it as a disguised DNI distribution?
- Non-grantor trusts may also be used to defer or avoid state income tax. If you live in a high tax state you can form a non-grantor trust in a no income tax state and the trust income may avoid your home state’s high income tax rates. Note that there are some complications to this planning as some states have tried to clamp down on these benefits.

Creating Separate Non-Grantor Trusts

- Can you create separate trusts so that you can spread income between each to save income taxes? If each trust earns less than $15,650 then income might be spread out to be taxed at brackets less than the maximum 37% bracket.
- The tax law provides a hurdle for that in that multiple trusts may be aggregated to prevent that result (Code Section 643(f)). If the trusts are sufficiently independent, e.g., each trust is for a different child, it may be feasible to have those trusts respected as independent. This could be important to trust planning generally, and certainly post-OBBBA.
- **Example:** You have 3 kids. You create separate trusts for each child. You and the 3 non-grantor trusts may now constitute four taxpayers to spread and expand tax benefits. This could be very powerful planning results.

Non-Grantor Trusts Costs and Hassles

Consider that for a non-grantor trust to provide tax benefits

- you have to first create the trust document,
- open a trust bank account,
- transfer assets to the trust,
- and have an annual trust income tax return filed (and that probably should be done by a CPA).

So, there are costs, complications, hassles and some tax negatives to this.

But these trusts can be created rather cost effectively, name family trustees and may be less costly or complicated then many types of trusts. Before proceeding make sure that the benefits seem to outweigh the negatives for you.

Savings Language for Non-Grantor Trust Courtesy ILS

- It is intended that neither the Grantor nor the Grantor's Spouse be treated under Subpart E of Part I of Subchapter J of Chapter 1 of the Code as the owner of any trust created hereunder and the Grantor directs that this Trust Agreement shall be construed and the trusts hereunder administered in accordance with and to carry out that intent. Accordingly, during the Grantor's lifetime and the lifetime of the Grantor's Spouse, and notwithstanding any other provision of this Trust Agreement, neither the Grantor nor any other "nonadverse party" as that term is used in Code Sec. 672(b) shall have the power (1) to purchase, exchange or otherwise deal with or dispose of any principal or income of any trust hereunder for less than an adequate consideration in money or money's worth, or (2) to borrow any principal or income of any trust hereunder, directly or indirectly, without adequate interest or adequate security; no person in a non-fiduciary capacity shall have the power (1) to vote or direct the voting of stock or other securities of a corporation in which the Grantor's holdings and the holdings of any trust hereunder are significant from the viewpoint of voting control, (2) to control the investment of any trust assets either by directing investments or reinvestment or by vetoing proposed investments or reinvestment, to the extent that the trust assets consist of stocks or securities of a corporation in which the Grantor's holdings and the holdings of the trust are significant from the viewpoint of voting control, or (3) to reacquire any trust assets or any portion thereof by substituting other property of an equivalent value; the Trustee shall not use any income of any trust hereunder within the meaning of Code Sec. 677 (including, without limitation, capital gain) directly or indirectly to pay premiums on policies of insurance on the life of the Grantor's Spouse and/or the Grantor (including, but without limitation, any form of split-dollar arrangement with respect to such insurance);

Savings Language for Non-Grantor Trust Courtesy ILS

- no income or corpus shall be paid or appointed to or for the benefit of the Grantor; no income or corpus shall be paid or appointed to or for the benefit of the Grantor's Spouse without the consent of an adverse party as defined in this Trust Agreement; no one (including, but not limited, to the Grantor's Spouse and the Grantor) shall hold a power of or participate in a disposition effecting the beneficial enjoyment of the principal or income of any trust hereunder within the meaning of Code Sec. 674(a) which power could be exercised without the consent of an adverse party as defined in this Trust Agreement except that the Trustee (other than the Grantor's Spouse or the Grantor) at least half of whom are neither related nor subordinate to the Grantor's Spouse and the Grantor may, to the extent otherwise expressly set forth herein, exercise the powers set forth in Code Sec. 674(c), and except that the Trustee (other than the Grantor's Spouse) may, to the extent otherwise expressly set forth herein, exercise the powers set forth in Code Sec. 674(d), and except that the Trustee may, to the extent otherwise expressly set forth herein, exercise the power set forth in Code Sec. 674(b)(4), and except that, if a beneficiary hereunder (other than the Grantor's Spouse) is expressly granted a power of appointment hereunder in a non-fiduciary capacity, such beneficiary may exercise a power of appointment only by Will, as otherwise expressly set forth herein, to the extent described in Code Sec. 674(b)(3); no court, other than a court within the United States, shall exercise primary supervision over the administration of any trust hereunder and no person, other than a United States person, shall have the authority to control any substantial decision of any trust hereunder, within the meaning of Code Sec. 7701(a)(30)(E).

OBBBA Impact Charitable Deductions – Overview

Deduction Limitations
Basis for Non-Grantor Trust Planning

OBBBA May Hurt Donations

OBBA May Hurt Charitable Giving

OBBBA may, by some estimates, decrease funding for the National Cancer Institute by $2.7 billion, or 37.2%. According to the American Cancer Society, cancer is expected to kill more than 618,000 Americans this year. Cuts to cancer research funding could significantly impact the ability to reduce deaths and suffering from cancer. If American generosity can fill some of that gap, that could be vitally important. And that is only one example.

Tax Benefits Motivate Charitable Giving

A key question for tax planning for charitable giving is whether reductions of tax deductions for donations will affect the dollars donated. We as a society need to encourage donations to support vital causes that are at the foundation of who we are as Americans.

Charitable Planning Post-OBBBA

- No doubt personal benefits, such as helping others, supporting important causes, etc., all motivate charitable giving. But tax benefits seem to be an important catalyst of many gifts, especially larger planned gifts. Further, tax benefits may motivate donors to give more.
- Consider the following: "*TCJA increased the standard deduction from $6,500 to $12,000 for individual filers, from $13,000 to $24,000 for joint returns, and from $9,550 to $18,000 for heads of households. As a result, fewer taxpayers will claim a deduction for charitable deduction and the tax savings for each dollar donated will be reduced. All this to say that altruism and trust motivations do not impact givers who donate less because of recent tax law changes; instead, receiving tax benefits may be one of the primary motivations why these individuals donate.*" Abby Rolland, "Why do people give?"
- https://blog.philanthropy.indianapolis.iu.edu/2019/11/20/why-do-people-give/, November 20, 2019. This report estimated that the 2017 Tax Act may have **reduced donations by $19.1 billion per year.**

Charitable Planning Post-OBBBA – Planning Ideas

Practitioners Should Alert Clients About Charitable Planning Changes

There are several OBBBA changes to charitable tax benefits which will be discussed below, and there are many nuances to charitable planning post-OBBBA that will be explored. Consider some of the following:

- Consider private foundations and donor-advised funds (DAF) to maximize charitable contribution deductions in 2025.
- Review existing grantor trusts and evaluate them for potential conversion to non-grantor trusts to optimize charitable giving tax benefits (keeping in mind that non-grantor trusts generally cannot take a charitable deduction unless authorized or directed in the trust instrument
- Review portfolios and assess opportunities for charitable giving strategies, not only donating appreciated assets as in prior years, but for some taxpayers using non-grantor trusts to maximize the effects of contribution deductions.

Charitable Planning Post-OBBBA – Planning Ideas

- Consider, similar to past planning, the concept of "bunching" charitable donations from several years into a single year, to maximize charitable contribution tax benefits. For example, instead of donating $20,000/year, consider donating $100,000 every 5 years, and qualifying for a larger contribution deduction from itemizing. Note that the time value of money should be considered as well.
- Consider the new $1,000 per person ($2,000 per couple) “above-the-line” charitable contribution deduction if a taxpayer does not itemize. This benefit can be meaningful to young and lower earning taxpayers.
- Reassess charitable tax planning strategies for clients in light of the new tax law changes, particularly those with significant business deductions.

Some Wealthy Taxpayers May Pay Little Tax and Get Little Tax Benefit from Donations

Some Wealthy Taxpayers May Not Obtain Any Contribution Deduction

OBBBA includes some incredibly valuable tax benefits for selected taxpayers. Taxpayers who reduce or eliminate their taxable income with some of the enhanced OBBBA benefits may get little or no benefit from planning for charitable gifts. What impact might that have on charitable giving? Might this dampen large donor motivation to give at a time when many charities will have greater need for donor generosity to replace government funding that will be reduced?

Some of the material tax benefits may include:

- 1202 Qualified Small Business Stock (QSBS) provides for a 50% gain exclusion for stock held for 3 years, 75% if held for 4 years and 100% if held for 5 years.
- Section 199A Qualified Business Income (QBI) Deduction provides a 20% exclusion rate and tax benefit was made permanent.
- OBBBA provides for current deduction for domestic research (including software development) expenses.
- Bonus Depreciation permits the deduction of up to 100% of the cost for property placed in service after January 19, 2025.
- Qualified Opportunity Zones (QOZ) provide a new and potentially valuable tax benefit.

Non-Tax Charitable Planning Post-OBBBA

- If there is little income tax benefit to be realized on charitable donations (but see below for ideas that may still help), and no estate tax benefits, what role will professional advisers play in the charitable planning process?
- Planned gifts, paid out in instalments over time, in part during an individual's life and in part under his or her estate planning documents still need to be planned. If the gift is large enough, the taxpayer might want to negotiate a donor agreement with the charity to have input and assurance that the charitable gifts made will in fact be used in the manner the taxpayer wants.
- Charitable gifts can be used in ways that involve children or other heirs to teach them the value of "giving back." That can all be bolstered by proper trust and other estate planning documents. So, even if an individual does not have complex tax consequences for his or her charitable giving, there still could be important planning to address.

OBBBA
Charitable Deduction Changes

Understand What Changed that Pertains To Non-Grantor Trust Planning

Pre-OBBBA Charitable Tax Rules

- Individual taxpayers generally can deduct the dollars or value of property donated to or for the use of a qualified US charity, under Code Section 170(a). Charitable deductions are limited based on specified percentages of the taxpayer's income (more specifically, contribution base): 20%, 30%, 50% or 60% depending on the charity involved. There are also limitations based on the character of the assets involved (e.g., a capital gain asset versus an asset that would generate ordinary income if sold),and, in some cases, whether the charitable recipient will use the property or sell it may impact the deduction.

Pre-OBBBA Charitable Tax Rules

- Generally, a taxpayer cannot claim a charitable contribution deduction unless he or she itemizes deductions and does not claim the standard deduction. Because of the OBBBA increase of the standard deduction amount, and the limitations on many of the deductions that could otherwise be itemized, most taxpayers do not itemize.
- Depending on the impact of the new increased SALT (state and local tax) deduction, some taxpayers who would not itemize before OBBBA may itemize after OBBBA. So, one of the first steps in determining what charitable planning might be considered is whether he or she will itemize deductions in the years of the donation (or whether bunching deductions to a single year may be one of most efficient strategies).

Charitable Planning Post-OBBBA - Above the Line Contribution Deduction

- The new higher standard deduction amounts means that most taxpayers will not qualify for an income tax benefit from making donations. However, OBBBA provides for $1,000 ($2,000 married filing jointly) above the line deduction.
- That is not much tax incentive for many taxpayers to donate, but for lower income or younger taxpayers it may be meaningful. To qualify , donations must be made in cash to a charity, other than a donor advised fund or a supporting organization. What about private foundations?

Charitable Planning Post-OBBBA

- **Carry Over of Unused Charitable Contributions** OBBBA provides carryover rules for the contribution amounts that a taxpayer is not allowed to deduct because of the percentage caps (20%, 30%, 50%, or 60%) of the taxpayer's income base. The excess amount that was not deductible in the current year can be carried forward and deducted in any of the next five years, subject to the same limitations.
- **New .5% Reduction of Contributions** For taxpayers who itemize their deductions, OBBBA added a haircut for charitable contributions. They must be reduced by 0.5% of his or her contribution base. The contribution base is adjusted gross income (AGI) determined without regard to any net operating loss carryback to the taxable year. So, for example, if your contribution base is $500,000, then .5% x $500,000 = $2,500 is not deductible. If you made $10,000 in donations that would have to be reduced by $2,500. This is combined with the 2/37 adjustment below.

Charitable Planning Post-OBBBA

- **Carryover** It appears that if your contribution deduction is reduced by the .5% limit above you can carryover it and deduct it in future years but only if the taxpayer otherwise had a carryover deduction from percentage limitations above.
- **High Limit for Cash Contributions** The increased 60% contribution limit for cash gifts to qualified charities is permanently extended.
- **Contribution Benefit Affected by Itemized Deduction Rules** Understanding charitable planning requires understanding planning for itemized deductions, which may include charitable contributions.

Charitable Planning Post-OBBBA

Contribution Benefit Affected by Itemized Deduction Rules

Understanding charitable planning requires understanding planning for itemized deductions, which may include charitable contributions.

"*The TCJA eliminated or restricted many itemized deductions for 2018 through 2025. This, together with a higher standard deduction, reduced the number of taxpayers who itemize deductions. In 2017, 31 percent of all individual income tax returns had itemized deductions, compared with just 9 percent in 2020*." Tax Policy Center, "How did the TCJA change the standard deduction and itemized deductions?" https://taxpolicycenter.org/briefing-book/how-did-tcja-change-standard-deduction-and-itemized-deductions.

The OBBBA changes, in particular increasing the SALT deduction, may result in more taxpayers itemizing deductions, but the overall percentage of taxpayers would seem to remain as a percentage of taxpayers quite low. It seems reasonable to conclude that the substantial majority of taxpayers will not itemize and will not qualify for a charitable contribution deduction. OBBBA increased the standard deduction to $31,500 for married filing joint taxpayers. That, however, does not mean that planning is not possible.

Charitable Planning Post-OBBBA

- **2/37th Reduction in Itemized Deductions**
- The amount of your client's itemized deductions including charitable (after applying limitations on home mortgage interest and miscellaneous itemized deductions) must be reduced by 2⁄37 (about 5.4%) of the lesser of: (1) the amount of itemized deductions, or (2) so much of the taxable income of the taxpayer for the taxable year (determined without regard to this section and increased by such amount of itemized deductions) as exceeds the dollar amount at which the 37 percent rate bracket under section 1 begins with respect to the taxpayer. For married filing joint taxpayers this is $751,600. So, if your client's income is less than that amount you would not have a limitation since you have no income above $751,600 so item (2) above would be zero.
- The purpose of this provision seems to be to limit the tax benefit your client may receive from contributions and other itemized deductions to 35% not the 37% maximum tax rate. It also suggests that a taxpayer may wish to spread income over several years to minimize the 2/37th reduction impact.

2/37 Reduction: Some Additional Thoughts

- Most individuals not itemizing each year should itemize **in 2025** to avoid the 2/37s limitation since it is not effective until 2026.
- If a person died in the first 11 months consider electing a fiscal year end of 11-30-25 for the estate to begin a new year 12-1-25? (avoiding the 2/37 rule for an extra 11 months)?
- The impact on Nongrantor CLATs could be substantial.
- A $40,000 SALT deduction will be reduced by 2/37s for many trusts.
- Margin and investment interest will be reduced by 2/37s.
- Legal, trustee and accounting expenses will also be reduced for trusts/estates by 2/37ths.

Tax Credit for Scholarships

- OBBBA creates a new tax credit for cash donations to certain state approved scholarship granting organizations (SGOs). The maximum credit is $1,700. If you treat a donation to an SGO as qualifying for the credit there is no double dipping. You also cannot report that payment as a charitable contribution and claim a deduction as well.
- OBBBA also provides that those receiving scholarships for qualified elementary or secondary school educational expenses do not have to report those scholarships as taxable income.
- The student receiving the scholarship must come from a family whose gross income is not more than three times the median gross income of the area.

Post-OBBBA Charitable Deductions and Non-Grantor Trusts

Planning Has Changed

Charitable Planning Post-OBBBA – Non-Grantor Trust Benefits

- **<u>Trusts and Charitable Deductions</u>**
- Trusts can be a great tool to increase tax benefits from donations. There are several distinct income tax advantages that a non-grantor trust may have over you as an individual to benefit from contribution deductions.
- Some possible trust income tax benefits may include:
- A trust can reduce its taxable income for charitable contributions without regard to the percentage limitations (20%, 30%, 50%, 60%) of the contribution base but, in general, only if the trust instrument directs or authorizes distributions of its gross income for a charitable purpose.
- Trusts are not subject to the standard deduction.
- A trust can elect to treat a distribution made during the first 65 days of the following year as if actually made during the prior year. That can provide valuable tax planning flexibility to a trust as compared to an individual taxpayer who cannot do that.
- Trusts are not subject to the .5% reduction of deductions, including charitable contributions.

Governing Instrument Requirement; 642(c)

There are also several restrictions and special rules:

- The trust document (governing instrument) must permit donations to charity. If the trust document does not provide for that then the trust cannot qualify for charitable donation deductions. The IRS does not believe you can modify the trust (e.g., decanting) to add a charity and thereby qualify. For new trusts this should be considered. So, if you are going to create a non-grantor trust for charitable planning be certain to include charities as beneficiaries. It may be possible to have a trust that does not have charitable beneficiaries invest in a partnership or LLC that can make donations and pass the deductions up to the trust (Rev. Rul. 2004-5).
- Trust donations must meet the requirements of Code Section 642(c) instead of the requirements of Code Section 170 that govern donation deductions for individual taxpayers. For example, you could personally donate an appreciated stock to a charity to claim a tax deduction (assuming you would realize a tax benefit from that deduction). A trust cannot do that as a trust must donate gross income to charity to garner a deduction. That means, unlike an individual, the trust would have to sell the stock and donate the proceeds.

Conversion Grantor to Non-Grantor

- You may have one or more existing grantor trusts that were created when the gift, estate and GST exemption was much less than the OBBBA $15 million permanent inflation adjusted exemption amount. Taxpayers should evaluate how those trusts may be repurposed post-OBBBA for more tax benefit.
- Even if there is no longer an estate tax benefit remember the law may change, the trust may provide important asset protection benefits, but it may be possible to modify the trust into a non-grantor trust to garner income tax benefits (Code Section199A, state tax deductions and charitable contributions).
- It may be appropriate to review the existing grantor trust with both an estate planning attorney and CPA. Go forward only if the taxpayer's advisors are sure that you can change the tax characterization of the trust. Also, evaluate what the income tax consequences of the conversion might be.
- For example, if you sold assets to a trust for a note the conversion could trigger a taxable gain. See, e.g., Rev Rul 77-402.

Adding Charitable Contribution Deductions

- If you convert an old grantor trust to a non-grantor trust but the trust does not name charitable beneficiaries, you might be able to use the partnership/LLC approach discussed above as per Rev Rul 2004-5.

Charitable Planning for a Moderate-Income Client Not Itemizing

- Moderate income taxpayers may benefit from the creative trust planning mentioned above. This technique may offer an interesting option for those who are charitably inclined and unlikely to receive sufficient benefit from bunching itemized deductions into one year or for those unwilling to time their charitable gifts to bunch them in one year.
- This non-grantor trust planning concept may be useful for a religious taxpayer who's accustomed to tithing and who wishes to gain some income tax benefit from doing so. You can create such a trust to benefit a class of people including your spouse, descendants and charities.
- To avoid grantor trust status, neither you (the settlor), nor your spouse, can benefit from the trust. Alternatively, could have the trust could require that if a distribution is to be made to the taxpayer's spouse that an adverse party must approve distribution. That is a person, such as an adult child, whose interests in the trust will be adversely affected by approving the distribution to your spouse.
- Perhaps, a "low-cost" trust could be created in the client's home state, as this plan may not warrant setting up the trust to a more trust tax-friendly state.

Charitable Planning Post-OBBBA Getting A Deduction When You Don't Itemize

- A portion of your client's securities portfolio could be transferred to the trust.
- Distributions to heirs or charity could be made by the determination of an independent trustee.
- Because the trust is characterized as a non-grantor trust (and it has to be planned and drafted that way to qualify), there's no standard deduction, and income is offset by the charitable contribution deduction so long as the requirements of Code Section 642(c), mentioned above, are met.
- This ensures that the contributions will provide an income tax benefit and leaves the standard deduction to offset non-trust income on the client's personal return.
- If the amounts available to allocate to charity exceed what is desired to give to charity in a given year, those amounts could instead be directed to the heirs listed as beneficiaries of the trust.

Charitable Planning Post-OBBBA Getting A Deduction When You Don't Itemize

Example: Your client is charitably inclined but lives in a low tax state and is unlikely to ever exceed the higher post-OBBBA standard deduction amount. Your client could gift $250,000 of marketable securities to a non-charitable trust to benefit charities (for example, a house of worship the client donates to regularly), children and other descendants. There likely will be little concern about allocating generation-skipping transfer (GST) tax exemption to a trust that's an inefficient use of GST tax exemption (because much of the trust property won't pass to grandchildren or other skip persons who attract GST tax) because the transfer tax exemptions enacted by OBBBA increased to $15 million which may be well above your net worth (although changes in the tax law may later suggest otherwise). Assume the $250,000 generates $12,500 of taxable income each year. The trustee pays $10,000 to charity and $2,500 to the grantor's descendants . The trust deducts the $10,000 charitable contribution, and all remaining income passes out to the children as part of distributable net income (DNI). If the trust paid all $12,500 to charity and then made discretionary distributions of trust assets to the children, the children would have no gross income to report from the trust. And the client may still qualify for the full income tax standard deduction.

Post-OBBBA Specialized Charitable Planning Considerations

Going Beyond Just the Contribution Deduction

Planned Giving - Post-OBBBA

For charities and planning giving experts, these complications will need to be addressed to help donors in the new environment. Their jobs will be more difficult because planning differences among various donors will be more significant than perhaps ever before. In fact, it may be more challenging for some wealthy donors who may no longer have significant current income taxes to provide tax benefits from donations. Further, very few wealthy clients will face an estate tax (.2% as discussed above) so solicitation of bequests may have to acknowledge that there may be no estate tax benefit. Ultra-high net worth donors may still face an estate tax so traditional charitable estate tax planning may be beneficial for them. If only .2% of donors may face an estate tax, some charities may evaluate whether or not they have the critical mass of large donors to justify developing staff and materials to address estate tax-oriented planning. Many charities have not updated their planned giving literature and websites in quite a while and a refresh may be in order.

Charitable Planning Post-OBBBA - Estates

Charitable Contribution Deductions for Estates

Charitable contributions under a will or revocable trust (i.e., by the estate) were important to many taxpayers when the estate tax exemptions were lower. But that has changed over time as the exemptions have increased, and OBBBA has further pushed that result.

Estimates are that only .25% of American households have a net worth of more than $30 million (2 x the new $15 million per person exemption). That is approximately 1 out of every 400 households, or perhaps 350,000 families in America.

Thus, few taxpayers will realize any estate tax deduction for contributions. That may further reduce what seems to be a trend of less emphasis on charitable estate tax planning as the exemption has climbed dramatically in recent years.

Charitable Planning Post-OBBBA - CLT

You Might Consider a Protective Charitable Lead Trust

There may be precautionary charitable contributions that some taxpayers might consider. Despite the new $15 million exemption being called permanent, there can be no guarantee that a future administration in Washington may not enact legislation reducing the exemption, perhaps substantially. If that happens what if you die before you can update your will or revocable trust? What if you are incapacitated (e.g., dementia) and cannot update your documents? That might result in a federal (and/or state) estate tax that otherwise could have been avoided. Perhaps, the next time estate planning documents are being revised, the client might consider adding a bequest to a charitable lead trust (CLT) designed to reduce or eliminate estate tax. With a charitable lead trust charities receive a specified payment (typically fixed dollar amounts for a specified number of years, the so-called lead interest) and following that the assets left in the trust can pass to heirs with little or no estate tax but possibly generation-skipping transfer tax.

Qualified Opportunity Zones ("QOZs") and Charitable Remainder Trusts (CRTs)

OBBBA permanently extended the QOZ benefits. QOZs are a tax incentive originally created in 2017 to stimulate investments in economically distressed communities. QOZs are located in census tracts certified to be low income by the Treasury Department. Taxpayers can invest in QOZ's by investing directly in such a project or by participating in Qualified Opportunity Funds ("QOFs"). If you reinvest capital gains from the sale of an asset into a QOZ or QOF you can defer taxes on those gains. A partial exclusion of the deferred gains can be realized if the QOF investment is held for five years, resulting in 10% of the deferred gain to be excluded from taxation. If it is held for seven years, an additional 5% can be excluded. If held for 10 years, then new gains from a QOF are tax-free upon sale. That could be a substantial tax benefit. However, these new rules are not effective until January 1, 2027. What if you have a large gain in 2026? Is there a way you might use a QOZ to defer that gain even though it is before the effective date? You might give that asset to a charitable remainder trust and in 2027 have the CRT contribute the asset to the QOZ. The gain experienced by the CRT will not be subject to income tax as CRTs are exempt from income tax and using an income only charitable remainder unitrust, the gain could be distributed to family members in later years when the benefits of OOZs can be realized.

Conclusion and Additional Information

Take Aways

Conclusion

- Existing Trusts should be reviewed.
- New Planning should not be overly simplified, "permanent" may not prove so.
- OBBBA is a massive and complex piece of legislation. It includes many provisions that directly affect tax planning from SALT, 199A, and charitable giving.
- However, the most significant impact may not be from the specific OBBBA changes, but rather as indirect results of other changes. Taxpayers will benefit from holistically and creatively evaluating what their planning options may be.
- Evaluate trust structure: grantor vs. non-grantor; completed gift vs. incomplete gift (and within that whether an ING or other structure should be used).

Additional information

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